

DIGITALIZATION OF RETAIL FINANCIAL SERVICES

Direct banking in Europe

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ABSTRACT

Due to growing customer expectations and development of digital technologies, retail banking has started to apply a business model aiming to reduce branch offices. This business model is called direct banking, and it is the central research subject of this thesis. The outcome of the research is to provide a marketing plan including recommendations regarding opportunities and challenges according to the said business model. The study can be useful for both traditional local banks and potential new players.

The thesis applies a deductive research approach and quantitative methods to analyze customer attitudes to direct banking. Secondary data is collected from books, published materials articles, previous studies, and internet sources. Primary data is gathered via an online questionnaire. The thesis report introduces the basics of the retail banking, the industry's digitalization trends and marketing in banking.

The results of the study show that there are currently 28 fully functioning direct banks in Europe. The results illustrate that people still value ATMs while the significance of bank branches is rather low. Regarding the direct banking business model, this is good news. However, it was also revealed that bank customers have a negative attitude towards the main characteristics of the direct banking concept. Nevertheless, they may consider opening an account in a direct bank in the future. To succeed, direct banks should pay attention to affordable account fees, providing excellent customer service and designing user-friendly online tools.

Keywords: branchless banking, digital transformation, digitalization, direct banking, marketing strategy plan, retail banking

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1 INTRODUCTION

This chapter aims to introduce the reader the nature of the research topic, explain research methods and approaches used in the research process and make a picture of research structure. First, the research background is provided, explaining author's choice for this topic and the importance of this research. Then thesis objectives and research questions are described, and research methods are explained. At the end of this chapter, the structure of the thesis is outlined to help a reader to easier navigate throughout the research report.

1.1 Research Background

Due to the new technologies, our behavioral norms have changed. Google, Netflix, Facebook, Amazon, Uber and other companies have fundamentally changed the way people interact with the world. Every industry and every business is forced to adapt to the new digital society, otherwise they lose competitive advantage. (Krishnan 2014, 30.) The banking sector is not an exception in this transformation of business conditions. Because they can be used to automate operations and allow an in-depth analysis of customer data, digital technologies help banks to be more efficient and offer customers tailored services.

Consumer banking is being transformed by several trends: increased customer expectations and needs, disruptive technologies and new business models. These factors contributed to the formation of a new business model in retail banking – direct banking. Direct banks are built around digital technologies as a core capability to provide customers financial services without a need for any branch network. Therefore, direct banks utilize remote service tools such as web banking, mobile app, telephone banking and mail. The concept of branchless digital banks is relatively new; 28 years have passed since the first entirely remote banking experience was introduced (Frost & Sullivan 2016, 19). Nowadays, both new entrants of banking market and large traditional banks see a potential in this business model. Cashless tendencies and

increased Internet accessibility reduce the importance of bank offices. More than 20 percent of branches are expected to be closed by 2020 (Sullivan, Garvey, Alcocer & Eldridge 2014, 11). Moreover, digital banking is considered the primary disruption for the retail banking industry, placing up to 35 percent of banking revenue at risk by 2020 (Accenture 2013, 3). All these aspects make the topic of direct banking an exciting and important subject to study.

The author has chosen this topic because of a personal interest in this area. Being a satisfied customer of two different direct banks in Germany and Russia, he realized the benefits of this concept, and he pursues to study background information and what is the potential of this business model. The author asked himself: How many people know about direct banking? Do they still use branches? What is their opinion on this business model? How many direct banks currently exist in Europe? Since the questions were quite broad and complex, the idea of the thesis appeared.

The research aims to provide a better understanding of the current digitalization trends in retail banking, identify the causes of transformation in the banking industry towards digital technologies, and investigate the existing and potential tendencies in retail banking. The new business phenomenon, direct banking, is selected as the main study subject. The concept is introduced and analyzed, and an overview of the European direct banking market is provided. The research is addressed to both traditional local banks, which want to diversify their product line with direct banking products, and potential new players, who are planning to enter the market as solely direct banks. The thesis includes recommendations on establishing an efficient marketing strategy for direct banks.

1.2 Thesis Objectives, Research Questions and Limitations

The research questions of the thesis are based on the main objective of the study. The aim is to support traditional banks intending to diversify their product line through direct banking as well as to support potential

new players planning to enter the market as solely direct banks. Therefore, the main research the following: How should the marketing strategy of a direct bank be like?

Saunders, Lewis & Thornhill (2009, 34) suggest to base thesis objectives on research questions. The below table summarizes the main research question as well as the related sub-questions and thesis objectives.

Table 1. Research questions and thesis objectives

	Question	Objective
Main	How should the marketing strategy of a direct bank be like?	To establish an effective marketing strategy for a direct bank product that is suitable for both existing traditional banks and new players who are considering entering the industry
1	What are the current digitalization trends in retail financial services?	To illustrate examples of digital transformation in retail banking
2	What is a direct bank and what is people's attitude towards a branchless bank?	a) To define direct banking as a new business phenomenon in retail banking b) To analyze people's opinion on it
3	How does the current framework of European direct banking look now?	To create a consolidated list of current direct banks in Europe and identify common trends and good practices
4	Which factors force people to switch a bank?	To understand customer behavior and customer loyalty in retail banking and determine the factors

A marketing strategy framework is the main outcome of the thesis; therefore it is the main thesis objective. Objectives one, two (part a) and four use matching research questions by clarifying specific topics to be studied. Objective three supports corresponding research question by stating that a list of current direct banks is used to answer the question. Objective two (part b) involves a survey.

It is important to narrow down the focus of research. This thesis focuses on the retail banking of personal banking products, more specifically checking accounts. Finally, the thesis is limited to discuss European markets.

1.3 Theoretical Framework

The theoretical background helps final users of the thesis and other readers to familiarize with the main components of the research topic. Discussing preliminary sources helps to understand the degree to which the topic has already been studied and analyze current ideas on a specific topic. Secondly, it supports a critical review of the existing researches. (Saunders et al. 2009, 89-90.)

The thesis includes three chapters creating the theoretical framework. The first of these chapters introduces the financial industry. Since the sector is broad, the chapter focuses on banking, its purposes, types, products, and regulations.

The second chapter starts a broader discussion on digitalization trends in retail banking. This is a global trend called digital transformation which is relevant for multiple industries. Thus this tendency is explored; then the topic of digitalization is explained focusing on retail financial services and how it reshapes the industry.

The last theoretical chapter supports the main research question and the main objective of the thesis. As was stated, the primary outcome of the

study is to design a marketing strategy plan for a new direct banking product. Hence, the third chapter reveals the main points of marketing in the retail banking industry. Customer behavior and customer loyalty are discussed in order to create a theoretical framework for a strategy plan.

1.4 Research Methodology and Data Collection

This subchapter describes different research techniques and approaches that help conduct empirical research in a strategically correct and coherent way. The subchapter also specifies which data collection approaches and research methods are used and explains the choices.

First, the chapter discusses the difference between the following research approaches: the deductive and the inductive approach. Then, the chapter moves on to introduce the quantitative and inductive research method. Finally, the chapter ends with an illustration of primary and secondary sources, which are two types of data collection.

Research approach

Academic research distinguishes two main research approaches: deduction and induction. The difference is in the overall structure of the research process. Deduction means that the research starts with gathering of existing knowledge on a topic, afterward hypothesis (or hypotheses) is created based on theory. On the other hand, inductive reasoning uses observations as the main source of information, then hypothesis (or hypotheses) is developed. (Saunders et al. 2009, 124-128.)

The figure below visualizes the process flow of both research approaches.

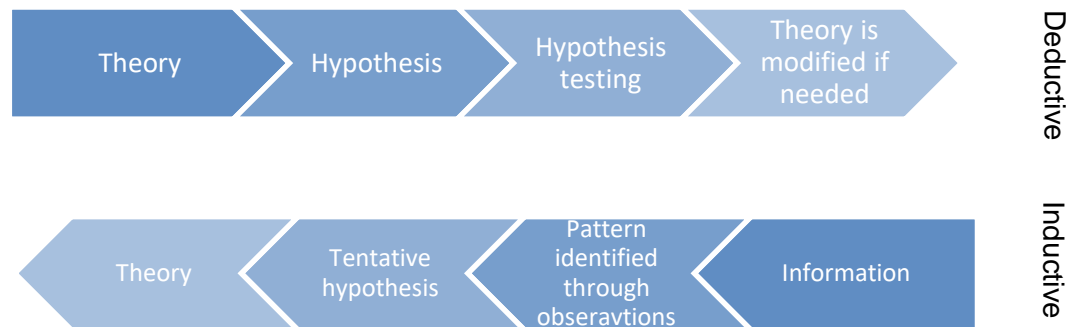


Figure 1. Process flows of deductive and inductive research approaches

Inductive reasoning is not common in business research (Eriksson & Kovalainen 2015, 23). The thesis applies the deductive method due to the nature of the study: important industry aspects and current trends should be explained before the empirical research.

Research methods

When a research approach is chosen, a data collection method should be decided. Data can be collected by using quantitative or qualitative methods or by combining the two. Quantitative methods represent numerical data which is analyzed using statistical software (e.g., SPSS, GNU, SAS, Excel) (Saunders et al. 2009, 12). This research method is especially useful for research that needs to study a comparatively large sample of people. Qualitative methods use words and context to study a particular phenomenon. Fewer sources are often utilized when research is based on qualitative methods.

In order to meet the thesis objectives and obtain enough data to find out how people feel about direct banking, data was collected through an online survey. The data was collected by sending the survey to potential respondents living in different parts of Europe. Indeed, survey is a research technique that allows data collection from a sizable population. (Saunders et al. 2009, 601.)

Data collection

According to Eriksson & Kovalainen (2015, 82), empirical data gathered by researchers themselves is called primary data. While the term 'secondary data' is associated with existing data that can be retrieved from various sources such as written or electronic sources. Both primary and secondary data are used in this research.

The figure below represents research approaches and methodologies used during the research process.

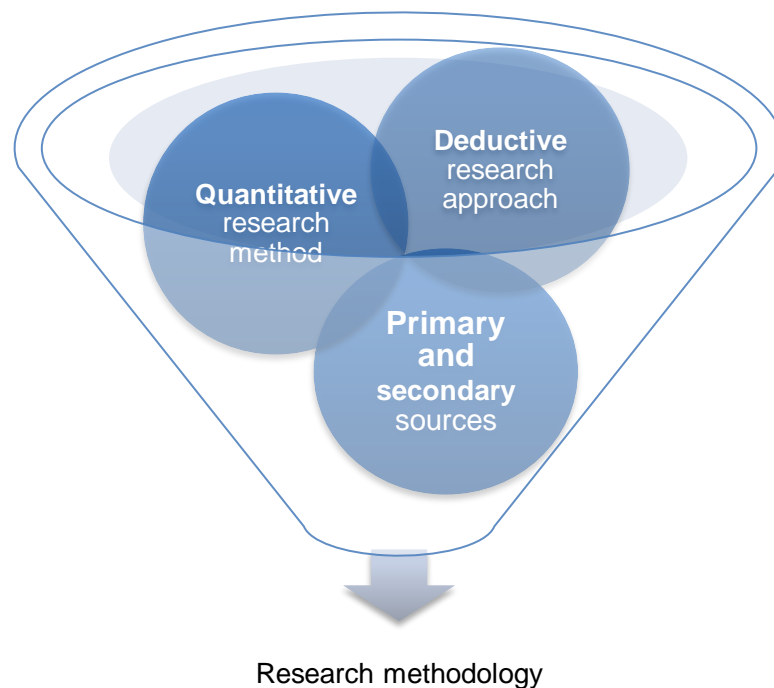


Figure 2. Outline of research methodology

1.5 Thesis Structure

This thesis report consists of two main parts: a theoretical and an empirical part. The theoretical part provides background information on the banking industry with a focus on retail financial services. Then author explains the digitalization tendency and direct banking as a result of digital innovation in retail banking. The central concepts of banking marketing are provided

to support marketing strategy plan. The empirical part describes data collection process and data analysis. The last component of the thesis is a marketing strategy plan, which is the final result of the thesis that summarizes all the fundamental findings from theoretical and empirical parts of the research.

The figure below illustrates the structure of the thesis. The covered topics are listed on the left side; corresponding thesis objectives are on the right side of the pyramid.

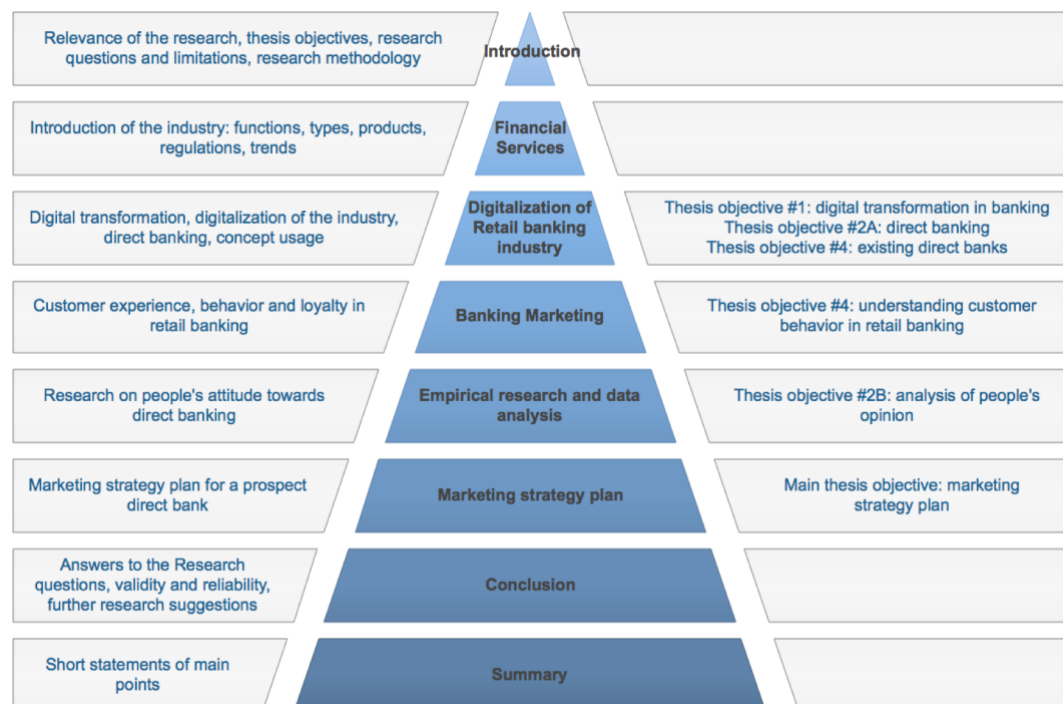


Figure 3. Thesis structure

The first chapter introduces research relevance, research questions, and limitations as well as thesis objectives, research methodology and data collection methods. It also explains the thesis structure.

Chapters two, three and four provide a theoretical background of the research topic. They include information on the industry, digitalization processes and banking marketing.

Chapter five describes the data collection process and data analysis results. This chapter also discusses how the research questionnaire was created and how the survey was carried out.

Chapter six offers a marketing strategy plan for emerging direct banking products. The plan contains recommendation based on potential opportunities and challenges of direct banking product as well as on communication, distribution and pricing strategies.

Chapter seven includes answers to the research questions stated in the introduction. The final chapter summarizes the main findings.

2 RETAIL FINANCIAL SERVICES

People imagine different mental pictures when they hear a word ‘bank’. This word is applicable to central banks, which serve as main financial regulators of the certain region. The term bank is also relevant for investment banks that raise financial capital for their clients. Some associate this word with a physical building where bank employees help customers open accounts and make transactions. The last case is close to a definition of a retail bank. This thesis illustrates that this association is not always the case anymore because of a strong influence of digitalization on the industry.

The first mentions of banking were recorded in early Egyptian and Middle Eastern civilizations. These initial banks served as state-owned storages of agricultural goods, where all deposits and withdrawals were recorded. Then money changers were introduced, so travelers were able to make donations to a church. Before the seventeenth century, banks were mostly used as storing places for coins, which were the primary mean of payment. In the process of time, banks refocused on deposits in gold. The first bank, which financed trade, government and church, was established in Italy. The name bank comes from Italian word “banco”, which used to mean a green textile where lenders completed their money exchange. (Omarini 2015. 5-6.)

At present, the term bank has obtained several interpretations. In addition, the perception of a bank has been changed due to diversification business decisions and mergers and acquisitions (M&A) that have lately occurred in the industry. Nowadays banks tend to represent a multi-product financial service institute that offers multiple products. Hence the recent concept of a modern bank also includes brokerage, insurance, investment management. (Omarini 2015, 3, 26.)

This chapter is dedicated to an introduction of the banking industry. Throughout the chapter, the author explains which financial institutions are called ‘banks’ and what is behind this term: functions, bank classification,

regulations and products. Then the chapter provides a reader with information on retail banking, its purposes, current status and perspectives.

2.1 Defining the term “bank”

The term “bank” may apply to different types of organizations which operate in financial services sector: from loans and savings organizations to commercial transcontinental commercial bank and investment banks. The term “bank” is also associated with central banks which regulate economic development of a country. In many European countries, one can notice a tendency in a market of financial services - there is often a large regional bank beside other three to five universal banks. (Heffernan 2005, 1.)

From a broad perspective, an institution of bank is a complex organization which includes a corporate entity, financial intermediary and a service provider (Omarini 2015, 4-5). The figure below explains why these three types of entity are relevant for the description of a bank, by matching entity type and its distinctive features.

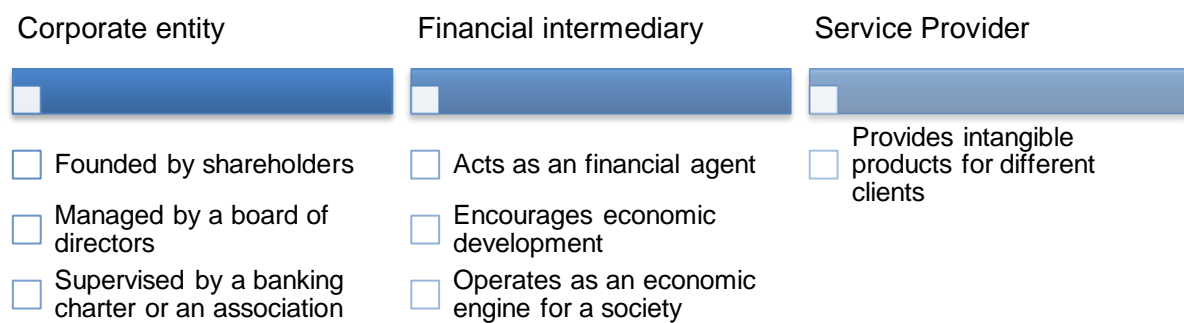


Figure 4. Bank as a complex institution (Omarini 2015)

As it is seen from the figure above, a bank as an institution can be studied from different standpoints. From a legal perspective, it is a corporate

entity, which involves more than one employee and operates under specific legal requirements (American Heritage Dictionary 2016).

Another option is to investigate this topic as a financial intermediary, meaning that the primary function of a bank is studied – take deposits from those who have savings and lend this money to qualified borrowers. In this thesis, the author focuses on a bank as a service provider, so bank is studied as an institution which offers customers intangible financial products. (Omarini 2015, 5.)

The fact that a bank takes control of loans and deposits, distinguishes it from other financial institutions (Heffernan 2005, 19). This and other functions of banks are discussed in the sub-chapter 2.3.

2.2 Revenue and Costs

A bank's monetization strategy is straightforward and widespread. The majority of banks' income amount to interests they earn on the credits they give. Simultaneously, banks pay interests on deposits they get; paying these interests is the main expenditure for banks. In other words, at the point when a bank charges more interest on loans than it repays for deposits, a bank starts to earn money. However, the difference between a loan and deposit interest rates is not a direct income item for a bank. This income also covers the risk-related costs in case if a loan is not repaid. (ING 2017.)

The above-mentioned income and expenses items are not the only ones for the banking industry. The table below consolidates fairly significant costs and revenue points of bank's operations.

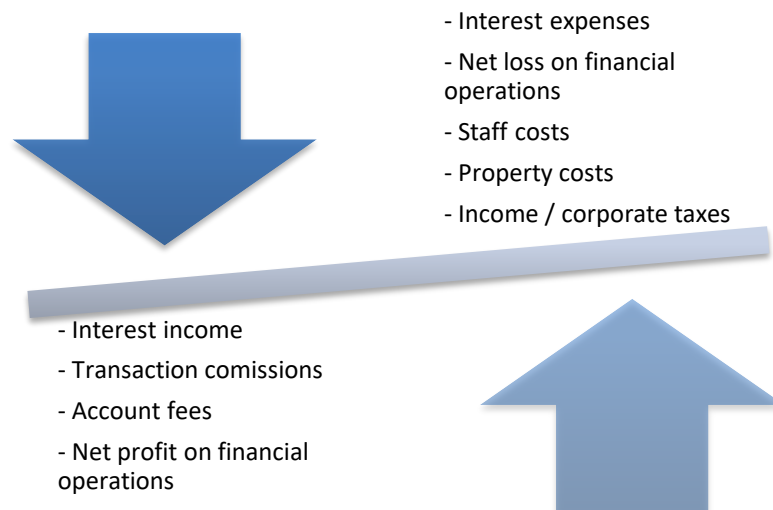


Figure 5. Main revenue and expenses items in banking industry (OECD 2017)

Net profit or loss on financial operations include a financial outcome of trading, portfolio management, foreign exchange operations (OECD 2017). Like other business, banks bear fixed costs such as personnel wages and rent costs. In addition, banks are obliged to pay payroll taxes on employee's income and corporate taxes. It is worth to notice that financial services are exempted from paying tax on goods and services in many jurisdictions. It means that banks may omit, depending on a country where they operate. (Martinez-Vazquez & Grace 2006.) According to Kovner, Vickery & Zhou (2014), a study has uncovered that there is an inverse relationship between a size of a banking company and its non-interest costs. It means the smaller a bank, the higher fixed costs.

2.3 Banks: Three Main Functions

As was mentioned, banks play an important go-between role in the financial system. Banks have three main functions.

Banks operate as issuers of loans to businesses and individuals. This is a critical function for society because it allows businesses get investments comparatively quick to production; people have an opportunity to get a

mortgage for a home even if they do not have enough money to make a one-off payment. This function boosts the economy and improves living standards. (ING 2017.)

Being a transaction agent, bank plays an essential role in the payment system. It is especially relevant nowadays when the role of cash becomes less important while the share of electronic payments rapidly evolves (Meola 2016a). The bank is the key intermediary in money transfers, direct debits, card payments and other electronic transactions. (ING 2017.)

Bank serves as a guarantee for people's savings. Moreover, banks are interested in attracting more deposits, so they pay interest on it. Thereby people protect their savings and may earn on interests. (ING 2017.)

Banks also have several secondary functions. Secondary functions are divided into agency and utility functions. Agency functions include portfolio management and periodic collection on behalf of a client. Utility functions contain locker facility maintaining, foreign exchange, project report preparation, participation in social welfare programs. (Asifulla 2016, 20-22.)

2.4 Types of Banks

One might have noticed that some of the bank functions mismatch with a popular idea of a bank. That is not surprising; as it is mentioned above in the first sub-chapter, the term bank is broad and applies to different types of financial services institutions. It leads the discussion towards an introduction of bank types. Banks are classified depending on various factors. In this sub-chapter, two main classifications are considered: by activities and entity ownership.

Banks can be private enterprises or state-owned. This is a classification depending on entity ownership. Most of the banks are privately owned, which means they focus on profit-making. However, some countries have national banks. Examples of state-owned banks are German Deutsche Bank and Banks of Canada. These banks operate as local system-forming

financial institutions, and they are classified as non-profit organizations. (Cornett, Guo, Khaksari & Tehranian 2010.)

Another classification distinguishes banks by their financial activities. Banking sector distinguishes four types: universal, commensal, investment and merchant. Banks that provide the most extensive range of products are called universal. These banks are engaged in stockbroking, investment management, insurance, payment system support and deposit/loans operations. Deutsche Bank, which has been mentioned earlier, is a vivid example of the universal bank. Deutsche Bank does not only provide private financial services but also actively cooperate with businesses, being presented in more than four hundred supervisory boards. (Heffernan 2005, 19.)

Investment banks are mainly focused on raising capital for large corporations and governments on global financial markets. These banks are strongly engaged in trading, investment management and corporate advising. Another type of banks, merchant banks, are similar to investment banks. Merchant banks provide capital to corporations in the form of shares. They provide corporate advisory to their clients as well. (Heffernan 2005, 20-22.)

Commercial banks offer retail banking services. They offer current account and loans and accept deposits (Heffernan 2005, 24). This type of banks is the main study subject. There are also other types of banks such as an offshore bank, community bank and co-operative bank. Their activities are narrow and rather specific.

2.5 Regulations

Currently, banking industry is strictly regulated by local central banks. In order to operate as a bank, the majority of jurisdictions require potential banks to meet specific financial requirements to get a special license. These requirements vary between countries but include such criteria as

minimum capital, prudent business plan and reliable bank senior officers, owners and controllers. (Heffernan 2005, 174.)

There are four main regulation activities executed by local central banks or other financial regulators. Firstly, finance regulator protects investors by forcing banks to disclose product information fully and inform them about risks. Secondly, local finance regulator ensures that financial sector is diverse enough to avoid the emergence of monopoly or other forms of competition scarcity. Another reason is to prevent unscrupulous players to the market. For example, these criminal organizations might be engaged in financial fraud or tax evasion activities. They may damage economic system and undermine the credibility of the financial system in a country. The last activity, central bank predicts and attempts to prevent possible agent actions which can harm monetary policy of a region. (Heffernan 2005, 174-175.)

2.6 Retail Banking

Banks that provide financial services to individuals are called either retail banks or consumer banks. The product line of a modern consumer bank is reasonably extensive. Retail banks offer such services as saving accounts, transactional accounts, credit and debit cards, mortgages and personal loans. The transactional account is better known as checking account in the USA and current account in the UK.

As it was mentioned at the beginning of the chapter, nowadays banks tend to diversify their range of provided services. Banks are interested in fast growth by providing more products to existing customers and by entering new financial markets. Despite the fact that sustainable growth is the main reason for diversification, there are two additional explanations why banks adhere to this tendency. First, according to the theory of cyclical business, companies are required to have a continuous growth to survive. Secondly, large banks tend to acquire smaller financial companies and finance start-ups if they expect that this investment would be beneficial for the main business. (Markides 1997; Santander Corporate & Commercial 2016.) Due

to product line expansion, the list of offered services is increased with wealth management, retirement planning, and insurance and brokerage services.

There are several sub-types of retail banks. Nonetheless, all of them make the same function, but the difference lies in diverse positioning, targeting and distribution strategy. Thus private banking is focused on high-income individuals. Offshore banks are interested in high-net-worth target group as well, but they locate their savings to low taxation jurisdictions. Savings banks are exclusively involved in the acceptance of savings deposits. Postal savings banks are savings banks related to local postal systems.

In general, retail banks use multifunctional branches as the main place of product distribution and assistance of existing customers. Banks design branches in a way that it satisfies all of the customers' banking needs. It is important to note that the role of common finance services is gradually decreasing. This aspect along with other current trends in the retail financial services is one of the topics discussed in the following chapter.

2.7 Current Trends

This sub-chapter concludes the discussion about the banking industry. The researcher examines how the retail banking landscape is changing and what are the factors for these changes.

The main current challenge for the retail banking industry is the attraction of new customers. Indeed, retail banks need new clients for growth, however this goal is hardly feasible in developed countries. (Sullivan et al. 6.) One of the solutions is entering a segment of retail banking products for youth. The fact, that there are approximately 1.2 billion young people globally, makes investments into the segment potentially profitable. It increases not only a customer base but also generates a higher stakeholder value. (Child and Youth Finance International 2014, 8.) Some banks have already designed youth-oriented products with a significant number of current account: Commonwealth Bank (Australia), OCBC Bank

(Singapore), ING Bank (the Netherlands), Intesa Sanpaolo Bank (Italy), Rabobank (the Netherlands) (Child and Youth Finance International 2014, 76-89). Another solution to overcome stagnation is to consider developing part of the word. The population in developed countries is aging, shifting focus from consumption to savings. While younger population, for example, as in Brazil, is more interested in consumer credits. (Sullivan et al. 2014, 14.)

Several banker managers are concerned about the future bank branches. The cause of it is a dramatic change in the whole retail banking ecosystem. With banking app in a smartphone and online banking in a browser, customers see bank branches in a different light. In other words, banks branch in not exclusive channel anymore. It becomes an additional element of the digitalized ecosystem. Since some people prefer a physical contact, it is not reasonable to assume extinction of bank branches. Poole (2016, 2) notes that it is not a problem to digitalize a bank branch. However, digitalization itself challenges the while retail banking industry. Therefore, bankers should re-think the role of branches in the updated landscape: how do they plan to attract customers there and why, what are the new customer journey and engagement touchpoints. (Poole 2016, 12.)

One more challenge relevant for players on US and European consumer banking markets is growing burden of regulations. Regulatory compliance is the main priority for bankers in those regions. Bankers intend to adjust activities in a way to stop viewing regulations as a burden and start utilizing it as a foundation for everyday operations. (Sullivan et al. 2014, 6.)

Data is becoming an engine of business processes for every industry, and retail banking is not an exception. To become more competitive and understand individual needs and wants, consumer banks should collect customer data and make use of it. (Brill, Drury, Harper & Wagle 2016, 3-7.) Marous (2016) suggests implementing a cognitive system to succeed in the digital age. The cognitive system allows getting entity, customer and competitor data by applying machine learning technology. Cognitive banking helps financial organizations to evaluate organizational efficiency,

obtain valuable data for decision making and making the customer experience more personalized. (Brill et al. 2016, 9-13; Marous 2016.)

To summarize, below is a list of priorities for retail banking for the future:

- target new generation
- explore business opportunities in emerging markets
- revise the purpose of bank branch
- design an efficient ecosystem considering new channels: mobile and online banking
- adjust to stricter regulations
- gather customer data and transform it into the more personalized customer experience.

This chapter has revealed two main outcomes. First, retail banking is a dynamic industry that needs constantly forecast changes and disruptions; moreover, banks should be strategically prepared to adapt to the changes quickly. Second, digital innovations reshape the retail industry, so banks should take advantage of new technologies in order to grow. The second point is discussed in more detail in the following chapter.

3 DIGITALIZATION OF RETAIL BANKING INDUSTRY

Digitalization has a strong impact on people's everyday life. Digitalization has a great influence on business processes as well. Indeed, digital technologies reshape almost every industry, and the financial sector is not an exception.

Digital transformation phenomenon is the core of this chapter. This chapter examines current innovation tendencies related to digital transformation with a focus on retail banking and direct banking in particular. First two sub-chapters review the essence of digital transformation and explains how this tendency affects retail banking. Third sub-chapter introduces the concept of direct banking and how branchless bank is designed. The last sub-chapter shows how the concept of direct banking is currently represented in Europe and summarizes common features of existing European direct banks.

3.1 Digital Transformation

3.1.1 Definition

This sub-sub-chapter defines digital transformation (DX) as a technological progress which affects fundamental business processes. In addition, this section outlines these affected processes by creating a framework of changing areas. Because the notion of digital transformation is relatively wide, this sub-chapter examines it from different perspectives and studies the gradual development and usage of this concept.

One of the first mentions of digital transformation is tracked in a book "Digital Transformation: The Essentials of E-business Leadership" written by Keyur Patel and Mary Pat McCarthy (2000). Authors were inspired by the first successful e-businesses such as Cisco and Priceline, and they assumed that these companies are pioneers in a large tendency of digitalization which would affect all businesses. The authors mostly

focused on the Internet technologies to describe the digital transformation. (Patel & McCarthy 2000.)

Fors and Stolterman (2004, 687-689) were one of the first researchers who concentrated on theoretical and empirical aspects of then-emerging concept of digital transformation. More importantly, they provided one of the earliest direct definitions of DX: a process towards “a world where everything is connected” through information technologies. Evidently, they observed digital transformation as a general tendency of our everyday life, hence their definition is not business-centric. (Stolterman & Fors 2004, 687-689.)

From a current business perspective, digital transformation is a change on how a company delivers value and drives revenue by implementing technology systems (Tiersky 2017). The main changing areas of business transformation are described in DX framework table later in this chapter.

There are two other terms associated with digital transformation, and it is essential to define them as well in order to avoid misunderstanding. These terms are digitization and digitalization. Digitization is a conversion of information into its digital analog. In other words, it is a process when images, sounds, and texts in a physical format are converted to digital binary format. Digitalization is the actual use of digital information. Such terms as big data, mobile apps, and the internet of things are the examples of digitalization. Digital transformation is a result of digitalization: the changes caused by the implementation of technical systems. (Khan 2016, 6-7.)

Together all these concepts: digitization (the conversion), digitalization (the process) and the digital transformation (the effect) represent 5th Kondratiev wave. First four waves are steam, steel, electricity, and petrochemical revolutions; each indicates a significant change in the organization of production processes. (Vogelsang 2010, 3.)

As it was discussed above, digital transformation means a complete change of business processes. Rogers (2016, 4-6) examined these

business processes closely and determined areas that are changing under digital transformation. There are five areas which jointly define a digital transformation framework. These areas are data, innovation, customer, competition and value.

Table 2. Digital Transformation framework (Rogers 2016, 8)

Area	Before DX	After DX
Data	Data is one of the tools for optimization	Data is a keystone for a value creation
	Companies utilize only structured data	Companies value particularly unstructured data
	Firms tend to avoid data production due to high costs	Firms generate data on every step of business processes
	It is challenging to store and manage data	The main challenge is to convert data into useful information
Innovation	Experiments are carried out occasionally; it is expensive and slow	Experiments are conducted regularly; it is cheap and fast
	Businesses tend to avoid failure	Failures are seen as cheap learning points
	Focus on a final product	Focus on a workable prototype
	Finding the right solution as the main challenge of innovation	Finding the right solution to a problem is the main goal of innovation

	Decisions are based on seniority and intuition	Decisions are supported by testing results and validations
Customer	One-way communication with a customer	Communication is interactive: both-ways approach
	Customers as a mass market	Customers as a dynamic network
	Businesses are the main influencers	Customers are the main influencers
	Economies of (firm) scale	Economies of (customer) scale
	Marketing in the way of persuading	Marketing to inspire and develop loyalty
Competition	Competition within specific industries	Competition under blurred boundaries of industries
	Lack of cooperation	Cooperation is a key
	Assets are kept in the firm	Assets are resided to outside
	Products with unique features	Platforms are designed with partners to exchange value
	A few leading competitors per category	The dominant players receive all due to network factors
Value	Industry defines value	Value is defined by dynamic customer needs

	Focus on execution of current value proposition	Focus on next opportunities
	Optimization of a business model is in a core of business processes	Development is in a core of business processes
	Changes are evaluated by impact on the current business	Changes are evaluated by how it could create next business

Data area of DX framework means how organizations produce and make use of information. Businesses used to gather data from customer surveys or stocktaking, so data production was mainly within business's own processes. Then the data was converted into information for evaluation, forecasting and decision-making purposes. (Rogers 2016, 9-10.) Now the data collection and transferring it into meaningful information is frequently associated with a term "Big data". Big data generally refers to three types of data. First, universal enterprise data includes customer information from CRM systems, e-commerce transaction information and financial performance from ledgers. Second, machine-generated data which is collected via sensors, weblogs, clever meters. Finally, there is social data that includes customer's feedback through social media channels. (Dijcks 2013, 3-5.)

The process of a development of a new idea, its testing and pushing it to the market is called innovation. Companies used to focus on producing a finished product due to high testing costs. Cost of failure was even higher, so it was predominantly important to avoid failure. Thanks to digital technologies, it became easier and cheaper to test ideas, so now it is possible to gather market feedback not only on the prototype before

launch, but also continue innovation process after the start off. (Rogers 2016, 11-12.)

Customer was seen as cumulative participants on the market. Hence companies aimed to attract as many people as possible with one product, so mass production was a widespread strategy at pre-digitalization times. For the same reason, firms utilized mass communication to attract as many customers as possible at the same time with a permanent message. With the emergence of digital technologies, businesses re-thought their approach to meet new requirements of more dynamic and socially connected environment. Customers use digital tools to discover new offers and evaluate them, purchase and share feedback. In its turn, firms utilize digital technologies to connect with customers and sell goods and services through e-commerce tools. (Rogers 2016, 9.)

Competition is the way how companies compete or cooperate with other firms. Historically, businesses assumed that simultaneous competition and cooperation is not possible: a company collaborated only with supply chain partners while it rivals with other companies on the market. Today, the competition has completely changed. Due to digitalization, business's main partners, supply chains, are becoming its primary competitors by serving customers directly. Whilst direct rivals shift to partners to overcome common external challenges. Moreover, digital tools develop a business model of the platform, which enables businesses to join forces and create a unique value for customers. (Rogers 2016, 9-10.)

Digital transformation reshapes the value proposition along with other areas. Before the digital age, business world saw a product value as a constant, defined by industry environment. Companies have chosen an approach to a constant growth, and digital technologies serve as a tool for value proposition increase. (Rogers 2016, 12.)

3.1.2 Causes

In the previous section, the changes in the business world due to DX are illustrated. As a consequence, another question arises: what are the causes of digital transformation which have created this significant amount of changes? These causes are frequently called digital disruptions; these disruptions are the topic of this sub-sub-chapter.

An occasion when an industry or business model is challenged by newcomers or existing (mostly tech) firms who are skilled in digital technologies and provide updated business models, approaches, and solutions that cause a significant change in customer behavior is called digital disruption. Digital disruption requires existing businesses to make a shift towards digital strategies. (Li 2015, 14-17.)

Digital disruption is not a technological concept as much as a human phenomenon. In other words, it is not only the innovative use of digital technologies but also about a change in customer behavior and customer's raised expectations. (Li 2015.) For example, if one bank releases online banking, then other banks on the market should develop their online banking tools to stay competitive. In this case, the first bank used digital technologies to overcome competitors by realizing a new user-friendly online tool; thereby this bank created a digital disruption for other banks on the market because they are forced to invest in the development of their own technologies.

Business scholars have revealed four main factors of digital disruption. First, technological innovation is the most obvious and impactful factor. Secondly, ecosystem factor includes changes in economy, regulations, and geopolitics. (Li 2015.) Further, speed plays a crucial role nowadays; companies optimize businesses processes to make them more efficient and less time-consuming. The final factor of digital disruption is rising customer expectations; when a user experiences an improved digital process, his/her expectations are set to a higher level. (Tiersky 2017.)

3.1.3 Impact on Industries

Previous sub-sub-chapter disclosed reasons why digital transformation emerged and how DX challenges traditional business models. Continuing discussion about digital transformation, this section highlights the essence of DX's effect on different industries. Primarily, it is essential to emphasize the fact that every business is under the influence of digital disruption. Indeed, every industry is effected – regardless of size, complexity and business model (Diorio & Sena 2017, 4-5).

Although digital disruption requires companies to adjust plans and operations, there is a positive point in availability. Digital technologies are available for every business. There is a sufficient amount of solutions and good practices. Implementation of digital technologies opens organizations a potential for growth and competitive advantage against other players in the industry. These growth potential points include enhanced customer experience, speed increase, reduced the cost of sale, access to direct customer channels and expanded reach. (Diorio & Sena 2017, 2-4.)

Implementation of digital transformation requires not only an adopted strategy but also significant investments. International Data Corporation (IDC) forecasts worldwide expenditure on digital technologies to be 1.2 trillion USD in 2017, which is higher by 17.8% in comparison to 2016. IDC predicts that annual worldwide expenditure on DX is going to reach 2 trillion in 2020. (IDC 2017.) It is useful to know how these investments are distributed among different industries. The graph below illustrates industries' investment behavior on digital technologies.

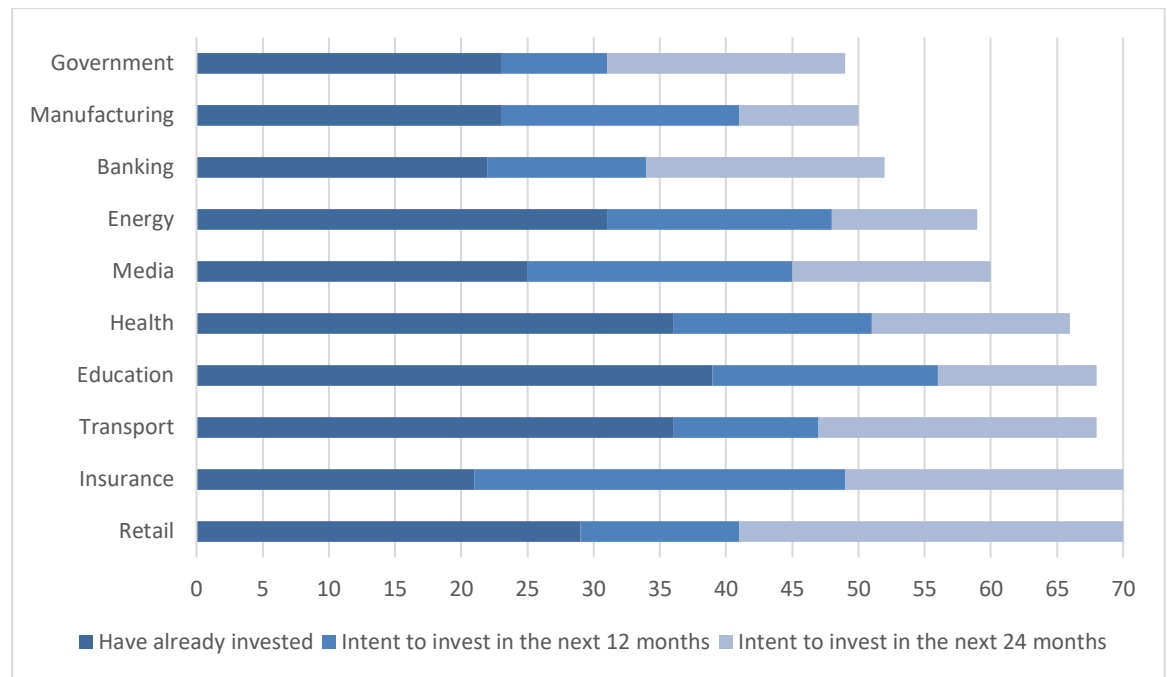


Figure 6. Organizations which have invested, or intend to do so in the next 24 months due to the challenge of Big Data (BBVA 2014, 10-11)

As the graph illustrates, retail and insurance industries put digital transformation as one of the top investment priorities. Retail industry invests in the development of smartphone applications, big data use and analytics and social media data (Campanelli 2017). Insurers mostly invest in mobile and social tools as well; also they prioritize cloud technologies to enhance and automate pricing decisions for a specific customer (Catlin, Hartman, Segev & Tentis 2015, 7).

The level of digitalization varies by industry. Some industries such as energy, healthcare, industrial goods, and logistics still lack a proper mindset for a successful digitalization strategy. It is caused by a small effect of digital disruption forces on these industries. On the other hand, industries like media and retail have recently experienced several major digital disruptions, so these industries achieved a higher level DX adoption (see table 3).

Table 3. Impact of digital transformation on different industries (Fæste, Gumsheimer & Scherer 2015)

Industry	Impact	Leaders of DX
Media	Digitalization of players and development of online stores	Amazon Prime, Netflix, iTunes
Retail	Online retailers are gaining market share (especially in electronics segment)	Amazon, eBay
Banking, telecom, insurance	Back-office improvements and digital approach for customers (e.g., online distribution)	
Automotive	Supply chain optimization and increased importance of websites	
Transportation	Private taxi services gained popularity	Uber, Lyft
Travel	Reduced significance of travel agencies, which are replaced by online distribution technologies	Booking, Airbnb
Healthcare	Digitalization is at a beginning stage, noticeable changes in front-office, and in research and development	

As can be seen from the table, digital companies are at the leading position in some of the industries; these firms did not exist before the digital disruption. The companies adopting the digital technologies face two main challenges. First, a business model that used to work for many years is not relevant anymore for a digital age. Second, updated business

models are not going to perform unless company shifts to DX and update all business processes. (World Economic Forum 2016, 4.) Therefore, most of the companies still need to capitalize on digital technologies: they need to adopt new IT systems, study the reshaped market and choose the right solution (Fæste et al. 2015). Next section shows firmly how these challenges affect the retail banking industry and how bankers adopt digital transformation.

3.2 Digital Transformation of Retail Banking

As it was discussed in the previous section, digital disruption raises customer's expectations, and they go online. Undoubtedly, retail banks have to follow this tendency and shift to online technologies. However, most consumer banks are not sufficiently prepared for this big step. Digitalization rate of European retail banking processes is between 20 and 40 percent. Moreover, ninthly percent of European financial institutions invest less than 0.5 percent of total expenditures on digitalization. As a result, digital technologies are involved in customer transactions and barely in any other aspects of retail banking. (Olanrewaju 2014.)

A recent analysis showed that approximately two-thirds of European retail bank customers prefer direct self-service technologies. It means that these people already actively use online technologies in other industries, e.g. groceries shopping and holiday booking via direct channels. (Olanrewaju 2014.)

Since DX changes customer behavior in banking, McKinsey corporation predicts an increase in banks' revenue by 30 percent due to greater use of high turnover services such as transactions and personal loans. The approaches of service provision and internal processes change under digital transformation, which positively effects operation costs. Thus the consultancy organization has also concluded that banks' expenditure can be decreased by 20 to 25 percent. Looking at this statistical estimations, it is fair to claim that digital transformation has a beneficial economic potential for European retail banking. (Olanrewaju 2014.)

Despite clear economic advantages and a strong need for direct channels among customer, retail banks do not adopt digital transformation at a proper pace. There are two explanations for this illogical business decision. First, bank executives tend to view DX too narrowly. In fact, they have introduced mobile apps, online banking, online payment calculators and web product comparison. However, DX has additional potential: digitalization of internal processes, data analysis, and digital frontline tools. Second, retail bank managers concern about security risks. Indeed, banks are responsible for customers' savings and personal data protection. Nonetheless, several other industries successfully secure sensitive information. (Olanrewaju 2014.) For instance, the airline industry processes payment detail and personal data of every customer, but companies developed and implemented functioning solutions (Enerstvedt Mironenko 2017, 276).

Knowing what the advantages of digital transformation implementation are and what are the remaining factors, another question arises: what are the important areas of the retail bank that should be affected by DX first. There are three areas of bank operations to be shifted towards digital transformation to obtain advantages of digital technologies: service optimization, front-end, and marketing. The figure below illustrates the direction of each component (first row) and possible changes (second row).

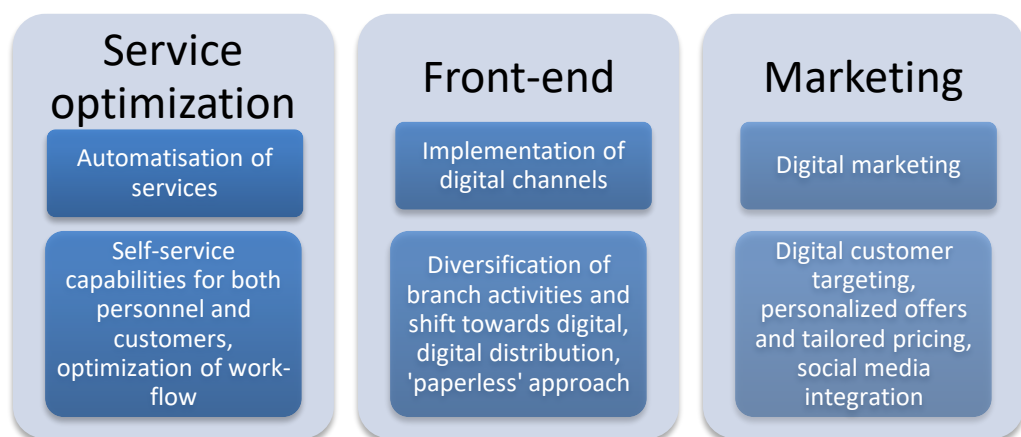


Figure 7. Digitalization actions for retail banking

The first area is service provision, which should be optimized by automatization. Servicing and fulfillment processes can be fully or partially automatized, provide customers and bank staff with digital tools. On the front end, banks should focus on digital channels instead of offline distribution channels (e.g. branches). Moreover, digital technologies can transform frontline into a paperless and more productive area. This can be archived, for example, by using tablets instead of paper forms and video conferencing instead of physical meetings. The final area that requires changes is marketing. Marketing strategies for the industry have changed, and it is important to adopt the new marketing rules to uplift customer base and revenues. With the new technologies, it becomes possible to target the right customers and make segments more precise via digital marketing tools. Thanks to these tools, banks can adjust offers and pricing according to specific customer needs. The new marketing rules encourage both-way communication between retail bank and customer by using social media. (Olanrewaju 2014.)

3.2.1 The Future of Bank Branches

As it was mentioned above, the role of branches is not as significant as it used to be before the digital disruption. This trend is especially evident in the UK, where around 760 bank branches are set to close in 2017 (White & MacAskill 2017). At the moment there are 25 branches per 100 thousand inhabitants. For a comparison, there are around 17 bank branches per 100,000 inhabitants in Northern Europe, comparison, which is seen as a pioneer in mobile and digital banking. To be precise, per 100,000 citizens there are 18 branches in Sweden, 23 in Denmark and approximately 8 in Finland and Norway. (Blakey 2017.)

Currently, more than 85 percent of retail banking transactions are digital (Baxter & Rigby 2014). Moreover, there is no reason to expect any growth in branch activities need. Traditional banks are not able to refuse from bank branches because their customer base includes non-digital-savvy users. Therefore, the best solution is to rethink the role of branches and

create a combination of physical facilities and latest IT solutions. (Rigby 2014.)

Rethinking the role of branch is not an easy task because it means to revise customers' habits, beliefs, taking into account recent technologies and customers' expectations (Jaubert, Ullrich, Dela, Marcu & Malbate 2014). In addition, retail banking differs from general retail due to the complexity of banking products. Even though people sometimes prefer personal contact with a bank representative, they also want to see a seamless integration of digital technologies such as electronic billing, online deposit, virtual assistance, availability of transaction list. (Baxter & Rigby 2014.)

Several leading retail banks revised a concept of traditional branches and created centers of banking products which serve as showrooms of complex products where customers can obtain assistance from experts. Some banks have implemented a video call options with a specialist at the central office. Other banks decided to make branches more casual and combined them with café. Also, one American bank utilizes video screens to guide customers through bank products. (Baxter & Vater 2014.)

As can be seen, there is no common solution for a branch digitalization. Nonetheless, retail banks all around the world started experimenting with possible digitalization options. Results of these pilot projects and customer surveys will identify useful and efficient solutions. (Baxter & Vater 2014.) Ultimately, flexibility is a core of modern banking operating models. Digital disruptions demonstrated that any industry changes quickly. Hence, flexibility is one of the main priorities in the process of digital transformation of bank branches. (Jaubert et al. 2014.)

3.2.2 Current Digitalization Tendencies in Retail Banking

Digital transformation has affected all industries, and retail banking is not an exception. This sub-chapter introduces digitalization changes in retail banking.

The key differentiator of the digital retail bank is personalization. It is reported that personalization amounts to 23 percent of the overall customer experience in banking. This technology support banks in creating deeply personalized services. Although traditional banks struggle to add empathy and personal touch in their products, advanced IT systems can create an essential mass digital emotional connection. Personalization trends also include five important aspects: trustworthy, meeting expectations, good experience, minimization of customer effort and empathy. These five aspects are critical for a successful digital transformation of retail banking. (KPMG Nunwood Investments 2016.)

The next transformation is ecosystems or so-called platforms. Open retail banking ecosystem means encouraging third-party businesses to work with a bank. By cooperating with partners, banks provide clients a highly diversified and competitive product, which generates additional revenue. (KPMG 2016.) 52 percent of bankers expect to collaborate with new digital partners shortly. Indeed, banking products can take a role as a platform for other products. (Accenture 2016.) For example, N26, a German direct bank, offers customers with insurance, credit, overdraft, savings, and investment services in its mobile app, while all these financial services are provided by bank's partners.

Banks acknowledge an increased importance of trust in the industry. Even though customers trust banks to hold their personal data and savings, clients are still skeptical about service value and obtained benefits. According to the 2017 Edelman Trust Barometer report, customers rank banks as the least trusted from an ethical perspective (Campbell 2017). Transparency in retail banking resolves this paradox. Implementation of digital technology helps customers to follow processes of their accounts. Eventually, digitalization supports retail banks in overcoming this trust paradox by improving transparency by enhancing safety and grow relationship trust. (Accenture 2016.)

Predictive and automatization intelligence has a growing importance in modern retail banking as well. Several banks have already implemented

these technologies; mobile apps notify customers about probable overdraft to protect them about unauthorized overdraft fee, the apps can even calculate spending limits according to customers' consumption behavior and monthly income. (KPMG 2016.) Big data helps banks to tailor customer service, personalize product range and understand specific needs. Banks are interested in efficiency improvement; thus 79 percent of bankers plan to invest in machine learning extensively. (Accenture 2016.) Banks can also commercialize data for revenue growth. For instance, if a customer posts about skiing holiday plans in social media, banks may capture it and offer special insurance and banking services. (KPMG 2016.)

Another digital trend in the retail bank is contactless payment technology. These payment options are created by device manufactures (Apply Pay, Android Pay, Samsung Pay) and multinational bank card issuers (Visa Paywave, MasterCard PayPass). This technology allows customers to pay by a short contact of a terminal and mobile device or a bank card. Undoubtedly, this technology changes customer behavior and encourages the development of cashless society. (Meola 2016b.)

3.3 Direct Banking

This subchapter discusses the central topic of the thesis – direct banking. The concept is explained in detail by providing causes and history of business model emergence, business model evaluation, customers' perception, and the architecture of a branchless bank.

3.3.1 Concept of Direct Banking

Banking has typically been a conservative industry which used to benefit from comparably high entry barriers foremost due to regulations and excess of identical products. However, cloud, mobile, online and big data technologies have severely reduced the entry barriers. In certain jurisdictions, central banks diminished regulations to support innovations in the banking sector. Accordingly, both entrepreneurs and existing banks

noticed a room for innovation in retail banking and create digital-only banks.

The following figure summarizes all the key points from the previous sections and illustrates the emerging business models. The figure includes recent megatrends of the industry and challenges that are relevant to traditional banks nowadays.

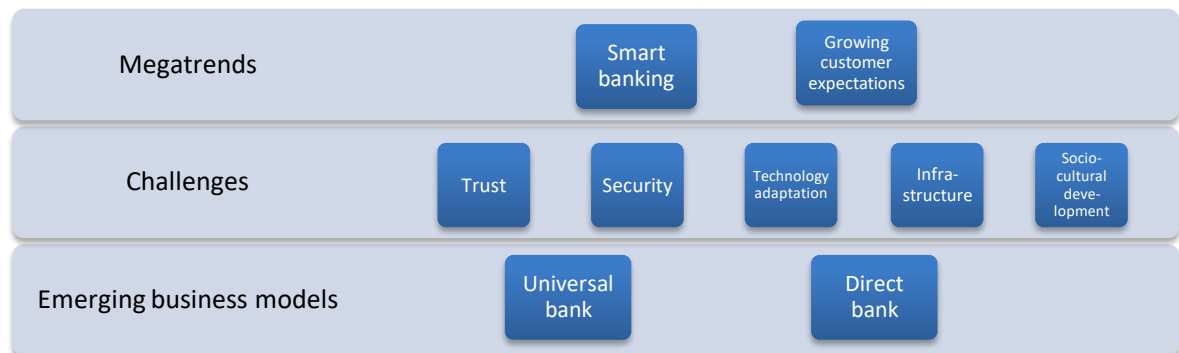


Figure 8. Outline of modern retail banking industry (Frost & Sullivan 2016, 11-18)

Smart banking includes all the digital disruption factors which have reshaped the retail banking industry. Smart banking solutions consist of using online and mobile applications, cloud technologies, analysis of big data and social integrations. Implementation of digital solutions gives banks a better risk management, improvement of customer experience, lower operational costs, increase of efficiency. However, in order to enjoy the benefits, banks have to create a transitional strategy and invest in digital technologies. (Frost & Sullivan 2016, 12-14.)

Another megatrend is described in digital disruption section of the thesis - growing customer expectations. Customers in all industries have more access to information, and due to this progress customers have increased their expectations towards products and services. Retail banking industry recognized this issue and actively invested in new technologies (see figure 6).

Besides megatrends, consumer banks have faced five challenges during digital transformation. Banks are required to accept the challenges and find appropriate internal solutions to stay competitive and profitable. One of the major challenges for the industry is trust. Banks have to ensure customers that the new technologies are safe and that smart banking improves trust in relationships with customers. The second challenge is security because usage of digital technologies might cause frauds and cyber crimes. Next, adoption of new technologies is the key activity of digital transformation. Banking operations should be digitalized reliably and efficiently. The fourth challenge is infrastructure, which is a cornerstone factor for a successful implementation of smart banking. Finally, sociocultural changes play a significant role in the modern retail banking industry. People's attitude towards digital technologies is changing; they rapidly accept new digital solutions in everyday activities. However, some customer groups might resist from digitalization in banking. Therefore, banks should conduct campaigns and training to smoothen the transition with an aim to inform customers about positive outcomes. (Frost & Sullivan 2016, 15.)

The retail banking industry proposed two business models which meet the requirements of the reshaped industry. One of them, updated universal banking, offers more flexible and tailored products to the targeted customers. The main idea of the renewed business model is to achieve a high level of economy of scale and to maximize efficiency. It is possible through implementation of digital technologies, correct targeting and a balance between online and offline channels. (Kobler, Bucherer & Schlotmann 2016.) On the other hand, the second business model, direct banking, suggests that the significance of offline channels has fallen.

Definition

Direct bank is defined by the number of branches and the degree of digitalization of operation processes. Accordingly, this business model is built around digital technologies as a core capability to provide customers the retail banking products and services without a need for any branch

network. Direct banks traditionally do not have branches, so they utilize remote service tools such as online banking, telephone banking, mail and mobile apps. Direct bank can also be called virtual, internet or branchless bank. (Frost & Sullivan 2016, 18.)

Due to branchless approach, retail banks eliminate indirect costs: facility costs and worker's wages. Since direct banks save resources on branch maintenance, it can positively affect customers in the form of lower service fees and higher interest rates. (Frost & Sullivan 2016, 18.)

History

The history of direct banking started on October 1, 1989, when the first direct bank was launched in the United Kingdom. That is why it was named First Direct Bank, as a first bank which does not need branch network to operate. The bank was initially formed by Midland Bank; then First Direct became a part of HSBC due to an acquisition of Midland Bank. The concept was designed around telephone banking, but with the advance of internet technologies, internet banking was launched in August 2000. (First Direct 2017.)

Since then more hundreds of direct banks were founded worldwide thanks to the advancement of IT solutions and a growing demand from customers. Direct bank business model is adopted by entrepreneurs and existing traditional banks.

Business model evaluation

Every business model has its advantages and disadvantages in comparison to other business models. The figure below illustrates both favorable and adverse factors.



Figure 9. Key drivers and limitations of the direct banking business model (Frost & Sullivan 2016, 20)

Starting with drivers of direct banking business model, the main advantage of direct bank is its availability anytime and anywhere where internet connection is accessible. As a rule, customers can access their account details via a web browser or mobile app. In theory, the account interface can be reached at any time. Direct banks often use aggressive customer acquisition strategies though additional rewards and premiums for account owners. Those premiums include cashback, the absence of monthly/yearly fees, higher interest rates, cash withdrawal from an ATM. Prevalence of digital solutions means that human factor error is completely excluded. High degree of digitalization improves customer confidence in security. (Frost & Sullivan 2016, 20.)

Consumers tend to see the financial sector as an industry with no room for dramatic changes. Strict regulations do not allow smaller player enter retail banking industry. As a solution, FinTech companies can cooperate with bigger banks to operate under their license. Nonetheless, this entry barrier is significant from the business point of view. Limited internet access in

some regions (e.g. Africa, Asia, Southern America) makes this business model less attractive. Also, technical interruptions and security breaches may significantly undermine customers' confidence in the idea of fully digital banks. (Frost & Sullivan 2016, 20.)

Business model adaption and customers' perception

Even though direct banks lack human interactions, people According to a survey conducted by J.D. Power, direct banks scored 865 points out of 1,000, while traditional bank got 824 points. In addition, customers of direct banks are more likely to recommend their banks to their family and friends: 76 percent against 55 percent for traditional bank customers. The research survey has also shown that direct bank clients are younger with an average age of 47 in comparison to 53 for traditional bank customers. (J.D.Power 2017.)

The survey also analyzed customer satisfaction of direct bank customers depending on different factors. For example, the market research company has revealed that customers who were provided with more than five features in their mobile app or web banking were more satisfied than those whose web or app tools had less than five features. The research indicated that direct bank customers are more flexible; approximately 6 percent of traditional retail banks can potentially switch a bank, while 19 percent of direct bank users said they would do it. (J.D.Power 2017.)

Europe was a place of the first virtual bank, and since that time some new direct banks started to operate fully. Direct banking performs well in Europe, especially in big markets. For example, virtual banking in Germany has a market share of 14 percent with approximately 18.2 million customers (Atzler 2017).

Direct banks also benefit from normal banks' bad reputation, consumer contempt, insufficient flexibility and low customer satisfaction. All these factors have an impact on the organic growth of direct banks. (TNS 2012, 4-5.)

According to Internal F&S intelligence, a global number of direct banks customers is expected to grow at an annual rate of 8%, and to reach 157 million in 2020. (Frost & Sullivan 2016, 25)

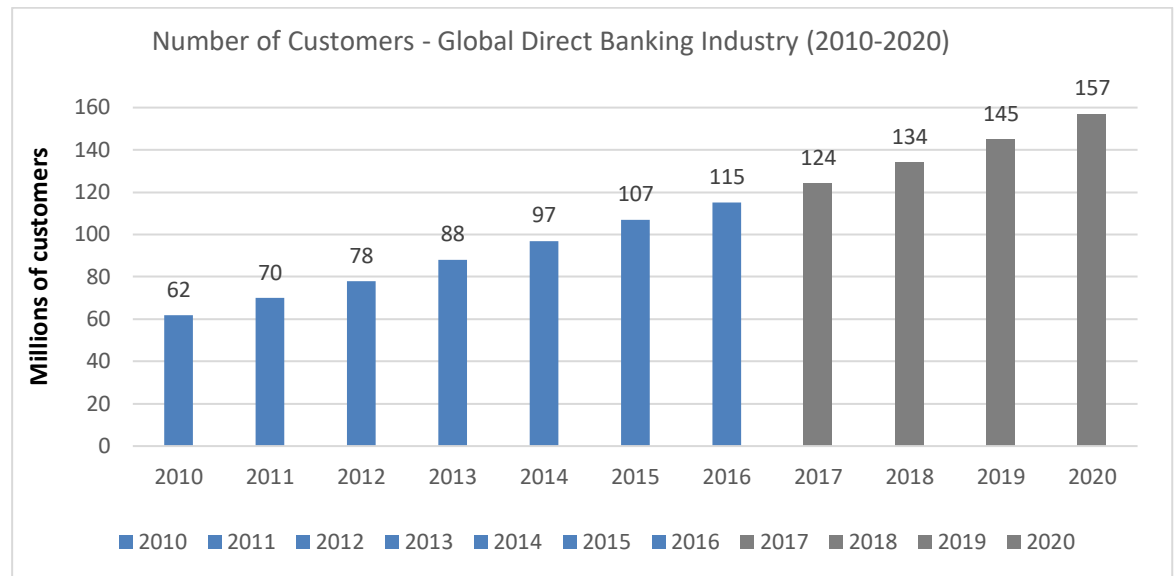


Figure 10. Size of global direct bank industry (2010-2020) (Frost & Sullivan 2016, 21)

3.3.2 Architecture of a Direct Bank

In this subchapter, the design of direct banking product is examined. The first part describes how front-end framework is changed under the influence of growing customer expectations. The second part discusses the back end of direct banking product, which is mainly shaped by the new technologies and industry trends.

Front-end is a visible part of a product, meaning that it involves everything what customer sees and interacts. It includes websites, mobile apps, offices, customer services. Some terms such as user experience (UX) and user interface (UI) refer to the front-end part of operations. The back-end is a server side of a product. It includes IT systems, databases, servers, security solutions, transaction procedures. (Napier, Rivers & Wagner 2005, 174-175.) Banking is an excellent example of an industry heavily

dependent on both front-end and back-end. For instance, when a customer purchases in an online shop, s/he first enters credit card information on the website (front-end), then the data is transferred to processing provider (back-end). The design of a direct bank dramatically differs from an architecture of a traditional bank.

The main differences are the absence of branches (front-end) and deep integration of IT systems (back-end). Sustainable business model of direct banking means that banks must be digitally optimized. They supposed to be attractive on the front end and efficiently automated on the back end.

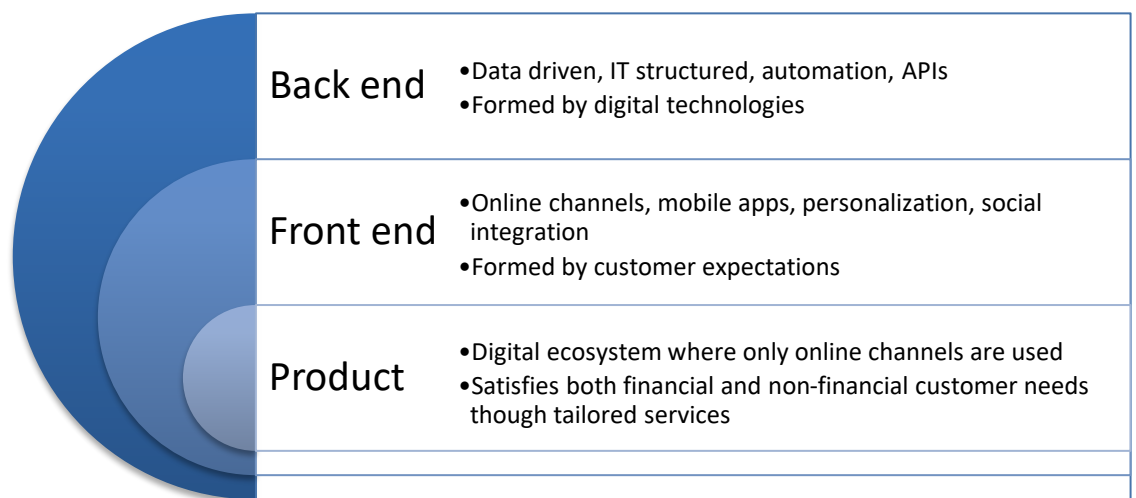


Figure 11. Main characteristics of direct bank architecture

Front-end

There is a significant difference in the front end between direct banking and traditional banking. Traditional banking is based on extensive branch and ATM networks; personnel plays an important role as well; whereas FinTech digital banks are built around efficient IT solutions and automatization. Direct banking implies that there is nobody and nothing between a customer and the bank, only customized, and personalized digital interface helps customers to navigate through financial services. For that reason, the business model of direct banking partially excludes offline channels and put online channels in the first place.

One of those online channels is mobile banking. In fact, direct banks tend to position themselves as mobile-first platforms. Indeed, several European direct banks do not allow customers to create an account on a website, making mobile registration the only option, for example, N26 (Eurozone). Moreover, some banks do not have web banking at all. App-only approach is adopted by Revolut (the UK) and some other direct banks. The most traditional digital channel for branchless banks is online banking via a web browser. Both online channels provide customers with a full range of financial services: mainly payments, transaction information, account settings. In addition, banks may offer savings and investment solutions, loans and insurance options and offers. (Krishnan 2014, 27-30.)

When a customer decides to become a customer of a certain direct bank, he faces one of the largest differences between a traditional bank and digital bank – identity verification. Indeed, due to the absence of branch chain, a bank employee is not able to verify identity in person. In most of the countries, banks are obliged to authenticate identity during the opening account procedure (Europa.eu 2017.) According to European Union's regulations, a legal resident of an EU country can open a basic bank account in his home country or another EU country (Europa.eu 2017.) In Europe, direct banks use three methods of ID verification. First, virtual banks utilize fully online approach through a short video-call verification. During a call, a user shows his identity card and an employee verifies it. (Direct ID 2017.) Second, ID verification in person through a Post Office or a branch of a parent bank. This approach is widely utilized by Comdirect and other direct banks. The final solution is personal identification with a bank representative. A bank representative (also called bank agent or carrier) arrives at the most convenient place and time for a customer and verifies ID; this method is used by largest Russian direct bank Tinkoff bank.

The problem with ID verification complements with the bank card delivery issue. Both operations cannot be fully digitalized, so banks find an offline solution for delivery. In Europe, banks utilize two different methods of bank card delivery. The most popular approach is delivery via post. In this case,

a customer receives a blocked card due to security reasons, which he can later activate through a website or an app. In some cases, ID verification and bank card delivery occur during one meeting with a bank representative. (Marous 2017.)

Because direct banking business model implies that digital channels are the only interaction interfaces, all direct banks heavily invest in the design of the high-end and user-friendly app and web platforms. Based on the definition of front end office, appearance and IT features are the main points which can distinguish one direct bank from another one. Therefore, banks use enhanced customer experience (CX) to attract new customers and improve customer retention. (Mylavarapu 2014, 2-3.)

In case of direct banks, the classical concept of customer experience (CX) becomes interchangeable with high technology idea of user interface (UI) because online interfaces are the only touchpoints between a bank and a customer. User Interface (UI) is an industrial design term for how interactions between a user and a system are implemented and designed. UI aims to create an effective user interface which makes it easy and enjoyable for a consumer to use it and obtain required results. (Mylavarapu 2014, 5-7.) Front-end office of direct banks operates under high customer expectations and develop new features to the interfaces. The main features are social integration and personalization which is a data-based insight and digital budgeting recommendation to the customers. (Accenture 2015.)

Back-end

Direct bank's back-end office has the same IT structure as a digital bank. Digital bank means that the absolute majority of operations and banking procedures are digitalized. Direct banks take advantage of digital technologies and optimize its services by implementation automatization, cloud systems, and in-depth analytics solutions.

Big data and analytics play an essential role in designing and tailoring banking products. By analyzing both operational (internal) and customer

data, retail banks optimize the efficiency and make the decision-making process more reliable and data-driven. Banks widely utilize big data and analytics tools for sales leads and risk management. (Daruvala 2013.)

Cloud computing allows digital banks to provide customers with more efficient and personalized customer experience by processing optimization of customer data. By implementation of cloud systems, banks' back-end becomes more flexible, and IT infrastructure turns into a more open platform with a possibility to connect APIs (Application programming interface). Also, cloud systems make retail banking more secure due to active customer information protection and backups. (Kaplan & Seth 2016.)

Automatization technologies support digital banks to optimize and atomize frequently occurred activities and algorithms on a back-end level. Depending on several factors, there are three different levels of automatization: partially or fully automated, and manual level. These factors include complexity, need for human decision-making and manual evaluation, legal regulations (e.g. review of a financial report), the extent of self-control. (Dias, Patnaik, Scopa & van Bommel 2012.)

3.3.3 Implementation Models

Since banking is a critical element of people's life and requires a certain level of security, companies need to get a banking license if they want to work in the financial services sector.

As it was mentioned in chapter 2.5, central banks are responsible for granting bank licenses, and the requirements vary depending on jurisdiction. As a result, not every digital bank that we know is not a 'bank', in other words, those banks do not have their own license to operate as a bank. If so, direct banks cooperate with existing banks. In some cases, virtual banks obtain a bank license, but depending on regulations, these licenses are restricted. For example, Mondo, a recent direct bank in the UK, does not have right to hold too many deposits and is not able to freely

connect to transaction networks during the first year of a license. (Dunkley 2016b.)

Back-end office, or infrastructure, processes data and support API, providing access to the web, mobile applications as well as to interact with ATMs. Back office makes sure that transactions and other services are efficient for both banks and customers. In some cases, digital banks prefer to outsource back office.

Channels are one of the leading distinction between traditional bank and direct bank. Direct banks mostly use online and mobile channels for communication between a bank and a customer. Direct banks realize that mobile apps or websites are the only communications tools, which are entirely responsible for building relationships between both parties. Therefore, banks focus on the development of efficient digital tools, which may substitute a bank branch. (Dunkley 2016a.)

To sum up all the information above, there are four concepts of digital banking depending on the following characteristics: possession of banking license, independence of marketing, product and sales strategy, channels and back-end office (see figure 12).

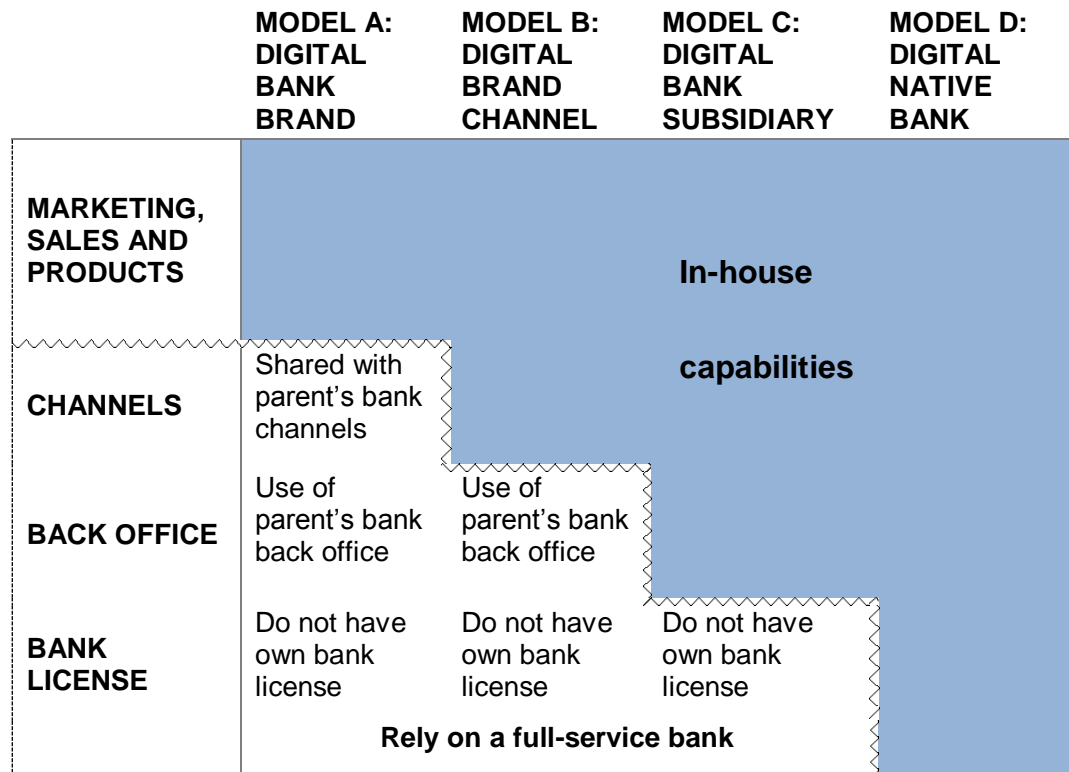


Figure 12. Digital bank models (IBM 2015, 3)

Model A is called digital bank brand. Mostly this model is used by established banks to attract millennials and digital-savvy customers. To distinguish themselves, they use a new branding, adjusted products, and updated marketing strategy. Digital bank brand model usually implies usage of existing infrastructure whenever possible. Examples: LKXA (by CaixaBank) in Spain and FRANK (by OCBC) in Singapore. (IBM 2015.)

Model B, digital bank channel model, is mostly utilized by entrepreneurs who attempt to fill the gap between digital demands from consumers and insufficient digital offer from banks. This business opportunity requires a particular focus on user experience and modern branding, for that reason model B companies use their own channels: online and mobile tools with a focus on enhanced user experience. Examples: Moven and Simple in the United States. (IBM 2015.)

Model C is called digital bank subsidiary and means that a new bank may benefit not only from separate digital channels but also from new back-end systems, which give an opportunity to innovate at the level of product creation. This enables a model C bank more flexibility in a creative thinking and constant change. Digital bank subsidiary is usually established by an existing traditional bank which sees inflexibility in its back-end office.

Examples: Hello bank (by BNP Paribas) in Europe. (IBM 2015.)

Model D, digital native bank, puts digital technologies in the core of philosophy and everyday processes. Banks communicate with customers only via digital channels. Examples: Tangerine in Canada and N26 bank in Germany. (IBM 2015.)

3.4 Concept Application in Europe

3.4.1 Grouping Direct Banks in Europe

This subchapter introduces readers the current landscape of direct banking in Europe. This is a critical part of the research because it shows to which extent the business model is utilized in the region, and in which countries specifically, whether customers tend to use this type of banking, and which type of digital bank model partnership do the banks prefer. The author consolidated all the functioning direct banks as of October 2017. The banks are sorted according to a number of customers. However, three banks do not publicly disclose the number of their clients.

Regarding the research purposes and relevance, not all banks were included in the scope. Here are the criteria:

- Independent banks (Model D) or affiliation with a parent retail bank (Models A, B and C)
- Operations are executed through international transfer systems (e.g. MasterCard, Visa)
- Web and/or mobile interfaces are capable of the basic retail bank services
- Meet the criteria of direct bank definition: absence of branches and digital technologies are at the core of all business processes

The table is provided in Appendix 1.

3.4.2 Key Findings of the Grouping Analysis

Looking at the consolidated table of direct banks in Europe, one can notice several critical general trends. By analyzing the table above, it becomes possible to identify current common trends and features of direct banking business model in Europe. These trends can be divided into three categories: prevalence of direct banking concept, digital bank models, and bank mergers.

First, it is worth to mention that the business model of a branchless bank is used all over the globe, and Europe second most enthusiastic region to implement this concept. According to Frost & Sullivan (2016), there are 80 operating direct banks in the world. With 28 internet banks, the idea of a virtual bank is more spread in Europe than in Asia, Australia, and Africa, but less than in Northern America. In other words, more than a third of all active direct banks are located in Europe.

Further, it is interesting to see that the idea of direct banking is not spread equally across the region. The most evident finding is that direct banking is not present in Northern Europe. The reason of this matter is in banking culture of the region. Banks in Nordics used to run well regarding profitability. Therefore banks are satisfied with performance results and loose sense of urgency. That is the reason why Northern European banks are not transforming business processes as rapid as banks in other regions. (Ruotsila, Ekdahl & Vitali 2015.)

The next category of consolidated table analysis is digital bank models. As can be seen from the table, the most common model is a digital brand channel, model B. Model B mostly used by traditional banks to diversify channel range. Second most spread model is a digital native bank (D). The largest independent bank in Europe is Tinkoff Bank, which is also the largest independent direct bank in the world (Frost & Sullivan 2016). The bank has 6 million customers and occupies 11% of the local market

(Tinkoff Bank). It follows by a digital bank subsidiary. In case of this digital bank model (C), a direct bank is relatively independent of the parent organization, but it is still a subsidiary of a bigger bank due to bank license or other reason. Least popular model is A, digital bank brand, which is mainly utilized by traditional banks with the slightly updated brand and the same back office.

Finally, the research has indicated a tendency of taking over a company in the retail banking industry. In more detail, parent banks tend to take over their direct bank subsidiary and integrate them into its main business. The most recent absorption of direct bank occurred with Zuno Bank which used to operate in the Czech Republic and Slovakia. Its parent bank, Raiffeisen Bank, announced the closure of Zuno Bank in 2017 after six years of operation. The official reason is the elimination of duplicate activities. All customers are moved to Raiffeisen Bank. (Symsite 2016.) A similar case happened with Barclays Direct, a direct banking product by Barclays UK, in 2013. The bank intended to integrate customers into the main business. (Barclays 2017.) These two examples demonstrate that although big traditional banks attempt to create a direct banking product, they do not meet some expectations and choose to close a direct bank.

3.4.3 Lessons Learned from Operating Direct Banks

At the moment, there are approximately 28 direct banks in Europe (see table 4), they have a customer base and all of them fully operate as of the moment of conducting the research. Therefore, the existence of these direct banks confirms that the business approach of the branchless bank is viable. Hence, there are several lessons learned from the current direct banks.

First of all, existing direct banks prove that economies of scale are one of the most important success factors. Indeed, a successful bank needs a scale to reduce operating costs and certainty in the business model. Confidence in the business model is also essential to attract customer: not all people trust their saving to unknown an internet startup. Thus model C

direct banks have the best spot because they position themselves as subsidiaries of well-known banks. For instance, First Direct by HSBC. (IBM 2015, 4.)

The second learning outcome is that there is no shortage of direct banks in most of the countries, especially it is the case in Germany, France, the UK, and Belgium. Moreover, direct banks do not compete only with traditional banks anymore, but also with other direct banks. As a solution, virtual banks should aim attention at customer adoption and provide the right experience for target customers. (IBM 2015, 4.)

The third lesson is an ability of direct banks to create and profit from ecosystems. Branchless banks offer not only savings accounts, but also an investment, wealth management, loans, and even insurance products. These products are provided in cooperation with banks' partners. However, these additional products are often profitable, and clients purchase them infrequently, so direct banks benefit from the provision of digital convenience and cooperation with partners. (IBM 2015, 4.)

To conclude this section, it is reasonable to state that traditional banks are still in a minor advantage over young direct banks, mostly due to lower brand recognition, scarce reputation, scale and absence of branches. Furthermore, newcomers struggle with becoming profitable. For instance, Fidor Bank, a German direct bank, became profitable in the fifth year of operations, after building a community of loyal customer base. (IBM 2015, 4-5.)

4 BANK MARKETING

As it was mentioned in the previous chapter, direct banks have a disadvantage in comparison to incumbent banks because of their low recognizability and insufficient awareness of business concept. Indeed, young digital banks do not have a solid customer base. It means that FinTech retail banks have to grow their client base from the outset. In addition, newly created banks should pay attention to their reputation through customer loyalty and customer experience, since it is mainly critical during the first years of operation. So this chapter investigates what the importance of bank marketing and customer behavior in retail banking and what influences customers' decision to switch a bank is.

Two previous chapters have introduced the financial industry and retail banking in particular, as well as digital disruption and digital transformation, and how these concepts relate to retail banking. Then the concept of direct banking was revealed. Continuing the discussion about the dynamic retail banking industry, it is important to introduce the basics of bank marketing, which will serve as a foundation for marketing strategy plan.

4.1 Role of Marketing in Retail Banking

Bank marketing is a combination of marketing strategies influencing all process of providing banking services in the best way to satisfy customers' needs. To build a proper bank marketing strategy, a bank considers products' performance, customers' demands, competitors' activities, and external factors which have an impact on the business.

Marketing helps banks to sell intangible financial products. In case of retail banks, marketing helps to attract new customers and retain new ones. Bank marketing has four main functions which contribute to solving both tasks. (Chorafas 1999, 130.) These functions are an adaptation to market's demand, operation function, coordination function and promotion function.

Marketers in retail banks conduct or order market studies to determine demands, needs, wants and trends of the dynamic industry. Having this valuable information, banks can design more attractive new products and services which have more value proposition for the customers. On the other hand, analysis of competitors' products and activities support banks to develop more competitive products and strategy. (Rhee & Mehra 2006.)

Operation function covers the process of designing and maintaining bank products and services to selected target groups. This function covers opening account procedure, service and product distribution, customer service and other topics from marketing perspective. (Rhee & Mehra 2006.)

Coordination function takes care of the quality of provided service. This function attempts to learn customers and their opinion on products, as well as approaching customers introducing them services and products. Also, this function requires frequent staff training and workshop events. (Rhee & Mehra 2006.)

Promotion function of bank marketing is responsible for brand and product promotion. The activities include advertisements in relevant marketing channels, participation in bank conferences, public relations and sending customers the right message. (Rhee & Mehra 2006.)

4.2 Customer Behavior in Retail Banking

This subchapter explains which factors influence customer behavior and loyalty in consumer banking industry. This topic is especially relevant now because of the recent late-2000s recession when customers' confidence and banking system has declined. Since then, marketing departments of retail banks design strategies for customer retention through loyalty.

Marketing professionals have revealed that customer behavior mostly depends on the age of a customer. First, customers of different age group have different expectations for their banking experience. Thereby, customers between 18 and 25 years old are interested in saving more, while 25-35-year-old customers are focused on managing their debt. From

the age of 45, clients shift their attention to protections of their money. Secondly, most commonly used retail banking channel is also dependent on the age. Indeed, the younger the customer, the more interest he has towards mobile and online channels. Thus, millennials (18-25) show the highest preference rate for online and mobile channels. Only 65+ customer group uses branches more often than online banking tools. (The Financial Brand 2016.)

Direct banking concept implies frequent usage of mobile banking app and zero usage of branches. From customer loyalty point of view, this is a beneficial condition for the business model. Indeed, customers who often use branches are almost three times more likely to switch a bank; while frequent mobile users are 40 percent less likely to switch a bank. In addition, branch visits are more than two times more annoying for customers than mobile interactions; whereas transactions made in banking apps are one-third more likely to satisfy customer than a transaction made in a branch. (Bain & Company 2015.)

To conclude this subchapter, there are three points how modern banks can enhance customer loyalty. First, quality of customer interactions is the most important factor of customer loyalty level. So, bank management should take care of training of employees who interact with customers. Second, retail banks must establish an efficient customer-centric marketing approach. The non-personalized approach does not work anymore, so banks should build individual-focused relationships. Third, proper customer data analysis allows banks to provide personalized offers. For example, a customer can be offered discounts in a cinema where s/ he frequently goes to. Clients appreciate this type of customer recognition. (Saiz & Pilorge 2010.)

4.3 Factors for Switching a Bank

Understanding why retail bank clients decide to switch their current bank is essential for young direct banks in order to create an effective marketing strategy. From the customer behavior point of view, these factors can be

divided into two groups: customers dislike something about their current bank (i.e. bad experience), and customers consider other's bank features more attractive.

Bank customers value convenience and relationships above all. So the main factors for staying in a current bank are family or friends use that bank, convenient location and knowing an employee at that bank. (Sells Agency 2012.)

Answering on question "why is another bank preferred?", customers highlighted any relationships to a new bank (27%), convenient locations (15%), good feedback about the bank (12%) and facility or friends use that bank (10%). Other responses included: more available products, more wide presence, better interest rates. (Sells Agency 2012.)

Nowadays, research results illustrate a growing tendency of financial services consumers to switch providers. Accenture's survey found out that 18 percent of customers switched their banks, and 27 percent opened an additional account in another bank. More than 58 percent of retail bank customers said that they use services of more than two financial services providers. (Gera, Wollan & Caminiti 2015.)

The behavior towards switching a bank varies depending on an age group of certain target groups. Millennials and young adults are considered to be a target group for direct banks, so the factors which influence their decision to change a bank worth a separate attention.

Approximately 45 percent of young adults (25-34-year-olds) rank high fees (monthly, transaction and ATM cash withdrawal fees) as the main reason for leaving their current bank. For millennials (18-24 year-olds) this issue is crucial as well – 36 percent of respondents see high fees as the main factor for switching a bank. On a second and third place for both age groups are poor customer service and ATM inconvenience. The FICO's research has also revealed that poor experience with mobile banking app increases bank's chances to lose customers. (FICO 2016.)

Millennials are very flexible when it comes to switching a bank account. They are 2 to 3 times more likely to close all bank accounts in their primary bank and switch to another bank in comparison to other age groups. Young adults are flexible as well; they are almost two times more likely to do the same. (FICO 2016.)

Digital banks can be considered, in a sense, a threat to traditional banks: 16 percent of young adults consider opening an account in digital banks in the following year. However, only 2 percent admitted that they are currently customers of such banks. (FICO 2016.)

5 EMPIRICAL RESEARCH AND DATA ANALYSIS

This chapter intends to describe the empirical part of the research. The main aim of the research is to study European bank customers' attitude towards the business model of direct banking. The research also investigates people's general opinion on their experience with current financial services providers and factors that might influence a decision to switch a current bank to a direct bank. The chapter starts with the description of the data collection processes and is finalized with the data analysis and the discussion of the key outcome of each questionnaire question.

5.1 Data Collection

This subchapter introduces the data collection methods which support the empirical research of the thesis. The figure below illustrates the steps and schedule of secondary and primary data gathering process.

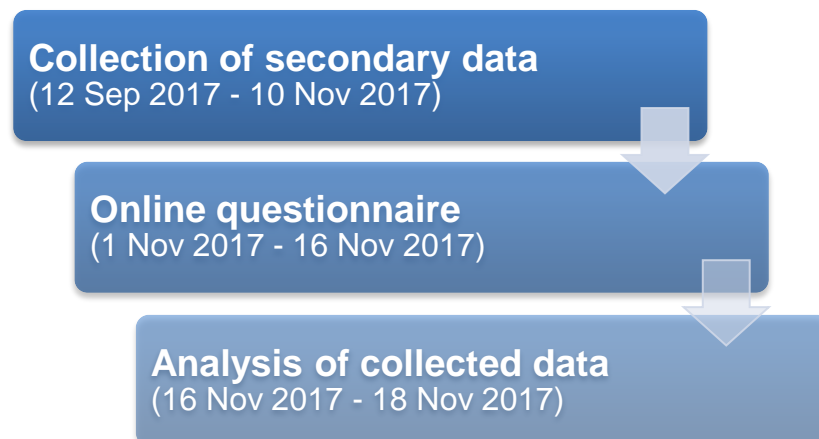


Figure 13. Steps of data gathering process

The first step of the research is a collection of secondary data, meaning that a desk research was conducted by gathering and measuring existing data from open sources (Saunders et al. 2009, 69).

During the final stage of desk research, the author created and distributed the online questionnaire in order to obtain up-to-date, reliable and

comprehensive primary data for marketing strategy plan. There are two reasons why the author decided to use an online survey as the only method of gathering primary data. Firstly, it is critical for research to acquire data from people of different age groups and across representatives of various European countries. Online technologies make it possible to share a survey with people from different places. Secondly, the idea of the research is to analyze opinion on the direct banking business model from potential customers' perspective; hence online survey copes well with the task to gather many responses without taking much time. For instance, an online interview is not as efficient method as online survey because it is more time consuming and more subjective.

The online survey was conducted among European bank account holders to study bank customers' opinion on direct banking and find out important tendencies which might be useful for marketing strategy plan. The online questionnaire was designed in Google Forms and launched on 1st of November 2017; it was available for half a month, until 16th of November 2017. The survey was available in English because the research implied receiving responses from different European countries.

The online survey consisted of ten questions and had a different format: short-answer text, linear scale, multiple-choice grid, and checkboxes. The reader can familiarize with the survey in Appendices section.

Overall, 152 responses were received during the response acceptance period. Since all of the questions were marked as "required", all of the received responses are complete; thus they can be processed and analyzed. The researcher decided that this is a sufficient amount of responses to start analysis because most of the age groups and European nationalities are represented.

5.2 Data Analysis

Data analysis is a process of transforming gathered data into useful statements which support researcher with handling research question

(Saunders et al. 2009, 308). This research is built around quantitative data which is represented by numerical or statistical form (Saunders et al. 2009, 414). In this subchapter, the author introduces each online questionnaire question, demonstrates the results visually and explains what the link between gathered data and the real business world tendencies regarding direct banking is.

The first two questions are irrelevant to the research outcomes. Those questions are “Where do you currently live?” and “How old are you?”. Those questions were included in the survey for internal purposes to check how diverse the survey sample is. As it was mentioned above, it is critical to have people from different European countries and different age groups. The figures below (figure 14 and figure 15) show that the sample is diverse enough to start the analysis of the survey results. There were no age limitations for this research. However, the research is focused on the analysis of European residences’ opinion; therefore, one response from a non-European resident was excluded.

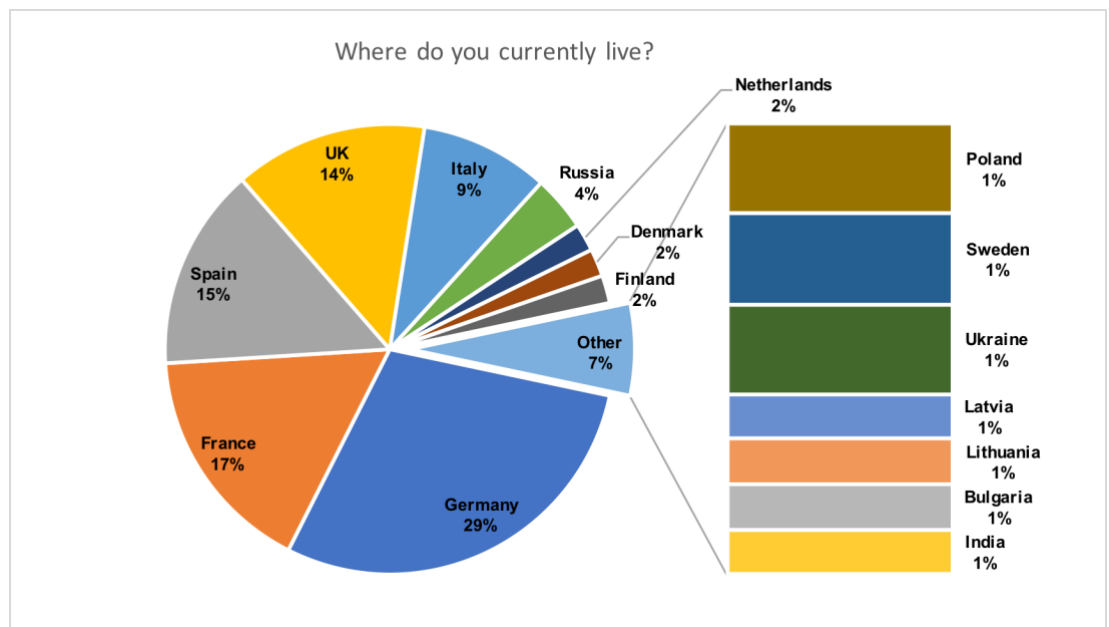


Figure 14. Diversity of respondents by country

There were participants from 16 different countries, with the greatest shares from Germany (29%), France (17%), Spain (15%) and the UK (14%).

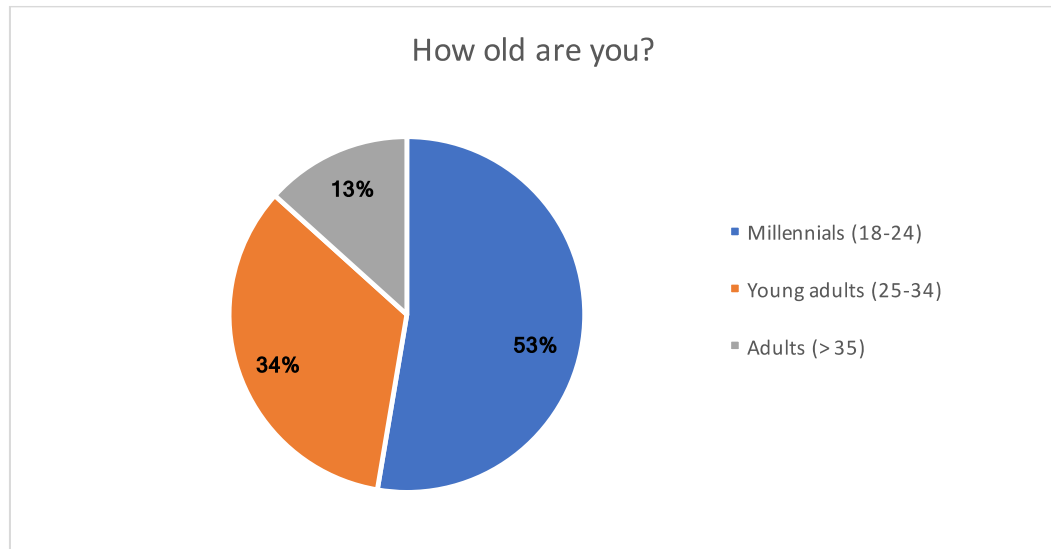


Figure 15. Diversity of respondents by country by age

Approximately a half of respondents were millennials (18-24-years-old), a third was young adults (25-34-years-old), and about one-sixth was adults (35 years old and more).

Third question (see figure 16) asked participants how many bank accounts do they have. This question was included into the survey for two reasons: to eliminate responses of non-bank customers (have 0 bank accounts) and to examine to what extent European retail bank customers are flexible by assessing a number of active bank accounts. One respondent selected "0" as a number of active bank accounts, hence this response was excluded from the following data analysis.

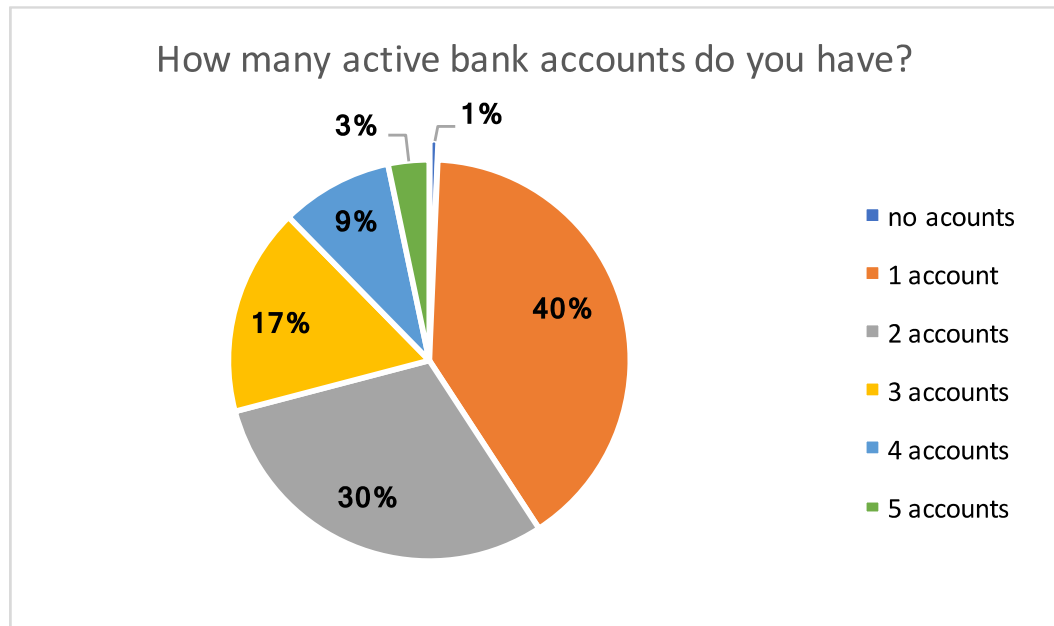


Figure 16. Quantity distribution of active bank accounts

The average number of active bank accounts is 2.03, so it is reasonable to say that nowadays customers do not confine themselves with having one bank account and prefer to use two bank accounts at the same time.

There are several explanations for the pattern. The main one is that customers use accounts for different purposes, for example, one account may serve as a savings account, while another is for online purchases or everyday usage. Another reason why people open more than one bank account is that there are different conditions. For instance, a customer may use one account abroad because of a reasonable exchange rate, while using another one in home country due to low ATM withdrawal fees.

Question number four was focused on analyzing preferred customer channel which clients use to utilize and manage their financial services. This is a critical question because it evaluates whether direct banking can survive in the modern customer behavior patterns, meaning that clients should prefer digital channels (web/mobile banking) rather than offline ones (branches, ATMs). The participants were asked to rank each retail banking channels by the frequency of usage (see figure 17).

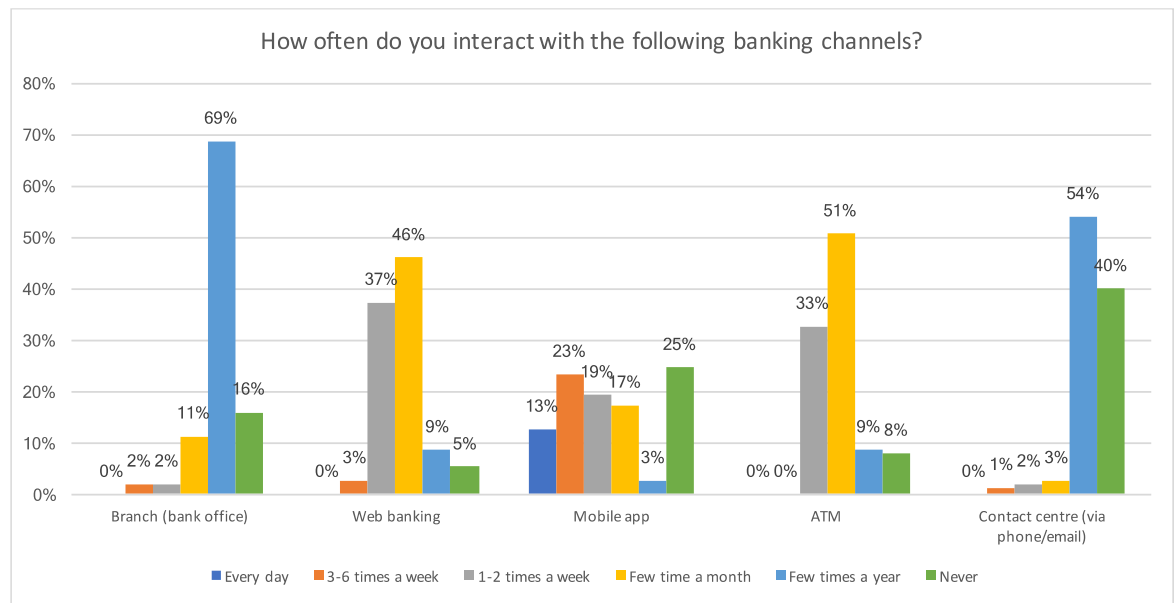


Figure 17. Retail banking channel preferences of the respondents

It is interesting to note that there is only one channel used on a regular basis (at least once a week) – mobile app. Indeed, approximately 55 percent of respondents stated that they use mobile banking app at least once a week, making this channel the most accessible for everyday banking. The second most used channel is web banking, which is used by 40 percent on a regular basis. Another banking channel, ATM, is not used on everyday basis. However, 84 percent of respondents said they use ATMs at least once a month, proving that this channel is relevant for the absolute majority of bank customers. The graph shows that branches and contact centers are rarely used by customers. Customers' preference towards digital channels and unpopularity of branches makes direct banking a prospective business model.

Fifth question intended to identify overall customers' satisfaction level by asking respondents to rank their satisfaction with the current bank on a scale from 1 to 10 (see figure 18). According to the results, customers are more satisfied with their current financial services providers than unsatisfied. The average score is 7.14 out of 10. However, only 17 percent of the participants strongly satisfied with the current bank, and 53 percent

see some room for improvement of their financial services experience. Therefore, 83 percent of bank customers who ranked their satisfaction level between 1 and 8 can potentially be customers of the new local players in the retail banking industry.

How SATISFIED ARE YOU WITH YOUR CURRENT BANK(S)?

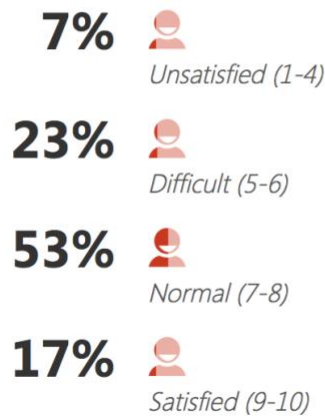


Figure 18. Current bank customer satisfaction level

The sixth question is a logical consequence of the previous question to identify factors which lowered respondents' satisfaction of their current bank (see figure 19). Participants were able to select all points they considered critical, so the overall result exceeds 100 percent. On average, respondents selected two factors. The most obvious outcome is that bank customers are sensitive to any kinds of fees including account fees and foreign currency surcharges. At the same time, respondents admitted that banks' reputation and brand are the least critical factors they do not like their current bank. However, it could mean either they do not consider branding and reliability as important factors, or they initially selected reliable banks with a strong brand. Some people used additional field "other", most of them complained about low-interest rates and withdrawal amount limitations.

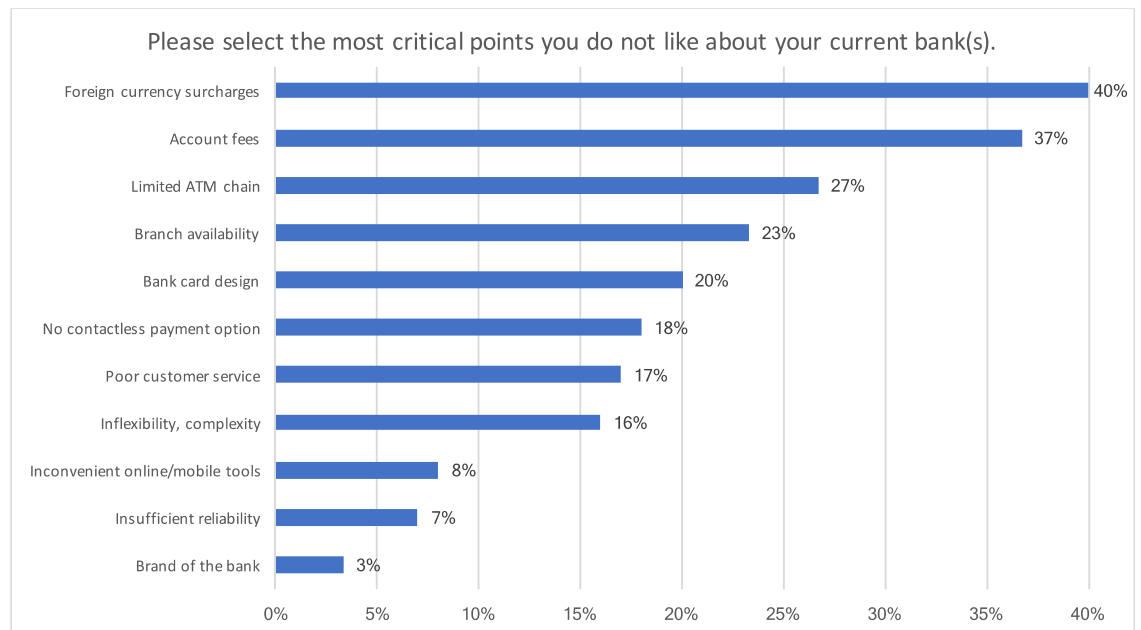


Figure 19. Participants' attitude towards critical factors of their current bank account

The following four questions of the online questionnaire referred to the concept of direct banking (see figure 20). That is why the explanation of the business model was included in the online form. The seventh question asked participants' opinion on the main direct banking related features: branchless, lack of face-to-face communication, being a customer of start-up/FinTech company, digital integration, and cash usage. The researcher assumes that participants are in favor of the features if a sum of positive ("strongly agree" and "agree") options outweigh negative ("disagree" and "strongly disagree") options.

To summarize the results of this question, this is a disadvantageous result for direct banking. The respondents are against four direct-banking-related features (i.e. branchless, lack of face-to-face communication, being a customer of a small bank, cashless banking) and in favor of only one (i.e. deep digital integration).

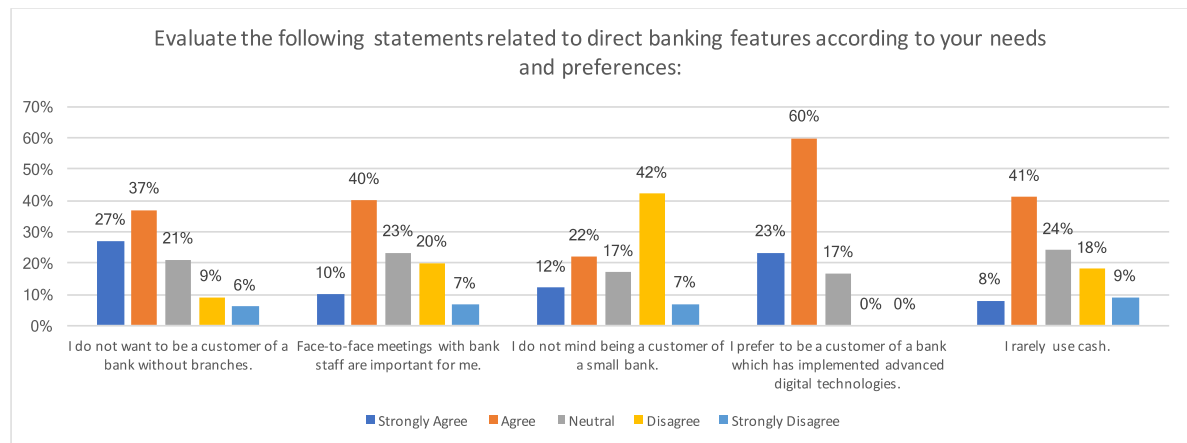


Figure 20. Customers' attitude towards features of direct banking concept

The eighth question aimed to illustrate whether customers consider opening an account in a direct bank (see figure 21). Looking at the results of the previous question, it is not a surprise that more than 1/5 of participants do not consider direct banks as their financial services providers. The most common response was “maybe”, meaning that people are still not sure about the concept and they need to know detailed information about the product.

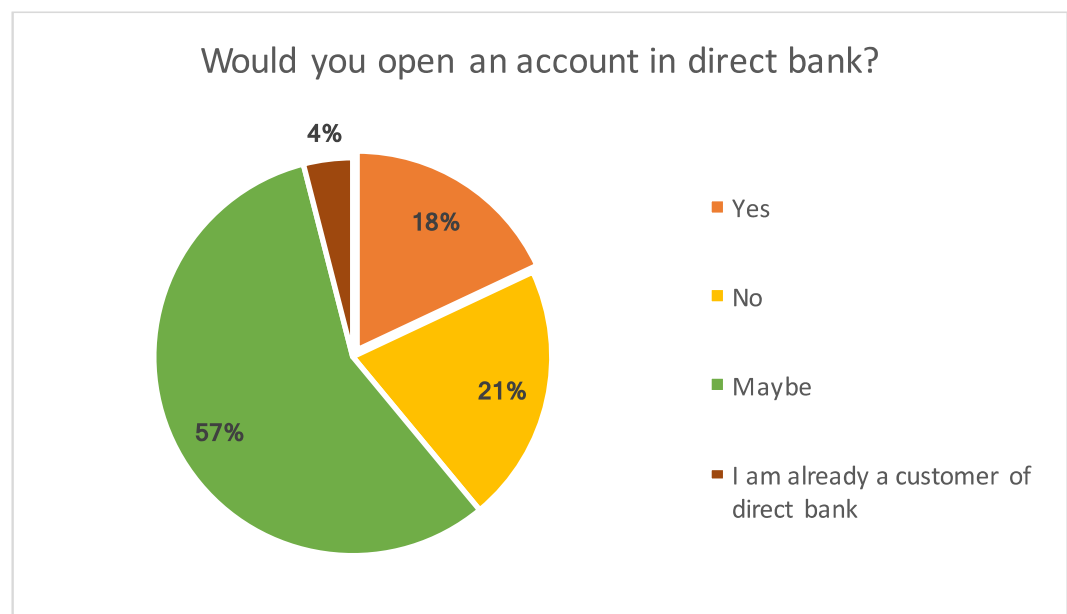


Figure 21. Respondents' willingness to become direct bank customers

Ninth question asked participants whose answer to the previous question was “I am already a customer of direct bank”. All six current customers of direct banks are the clients of the largest European direct banks: ING DiBa (5 responses) and Tinkoff Bank (1 response).

The goal of the final question was to identify factors which might encourage people to open an account in a direct bank (see figure 22). Respondents were asked to select 3 factors, so the sum of the responses exceeds 100 percent. The results illustrate the same pattern as in the question 6; retail bank customers are prudent when it comes to account and additional fees. Customers undoubtedly value fee-free conditions of a bank account.

On the other hand, the survey results show that while customers are not willing to pay to a bank, they are not highly interested in getting benefits as well. Those benefits include cashback, discounts, high-interest rates. In addition, customers are not concerned about obtaining loans, insurance or investment products via their mobile bank app.

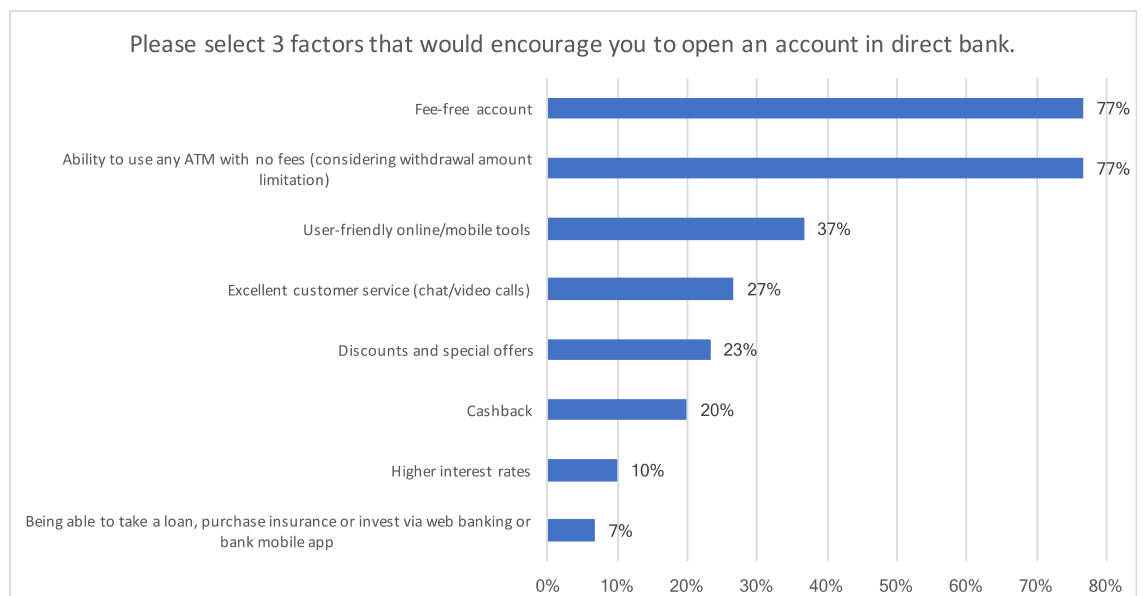


Figure 22. Participants' attitude towards factors for opening an account in a direct bank

As a result of an online questionnaire, 152 responses of European bank account holders of different age were analyzed; responses from 1 non-European and one non-owner of a bank account participants were excluded. The analysis of 150 responses shows that nowadays retail bank customers are not limited to one bank account, having on the average two bank accounts. This leads to a conclusion that customers are flexible with banking products and adjust them according to their needs. As for banking channels, participants classified mobile bank app as the most common channel for everyday use. However, a quarter of respondents have never used mobile app of their bank. While branches and contact centers are recognized to be the least popular banking channels. Web banking and ATM play an important role in customers' time-to-time banking experience. The analysis demonstrated that overall customers are satisfied with their current financial services providers, but 30 percent of clients are rather unsatisfied, meaning that they may switch a bank if their needs are heard. Customers are highly concerned about account fees and other charges. Therefore, elimination of fees considered to be the best strategy to attract new customers or enhance the loyalty of the existing ones.

Half of the online questionnaire was related to direct banking. The analysis has demonstrated that respondents are still unsure about the business model of direct banking; only 18 percent of participants consider opening an account in direct banking. The main reason is certainly a high level of satisfaction with their current bank. Also, 54 percent of survey participants stated that they do not want to be customers of a branchless bank. 50 percent of respondents said they value face-to-face communication. Direct banking implies minimization of cash usage because direct banks usually do not have own ATM chain. Nevertheless, the research has discovered that cash and ATMs are still in active usage despite of penetration of bank card, contactless and mobile transaction methods.

6 CUSTOMER-CENTRIC MARKETING STRATEGY PLAN

This chapter is dedicated for customer-driven marketing strategy plan. Simultaneously, this chapter answers the main question of the research: “How should the marketing strategy of a direct bank be like?” The aim of the strategic plan is the creation of an effective marketing strategy for direct bank product that is suitable for both existing traditional banks and new players who are considering entering the industry. The chapter starts with industry evaluation to understand what factors influence the competitive intensity in the retail banking industry. The evaluation is conducted using Porter’s five forces model. Then direct banking business model is assessed utilizing SWOT analysis and other marketing analysis concepts. When both analyses are provided, the author presents a customer-driven marketing strategy featuring 4C marketing mix.

6.1 Retail Financial Services: Industry Evaluation

This subchapter introduces retail banking industry evaluation. Since new players in the banking industry are included in the list of the final users of the marketing strategy plan, it is important to describe which forces shape competition framework of the industry.

The evaluation is conducted using Porter’s five forces analysis concept. The concept refers to microenvironment forces which affect company’s ability to serve customers and make profits (Porter 1985). The figure below illustrates the factors which currently affect retail banking industry in Europe based on conducted desk research authors opinion.

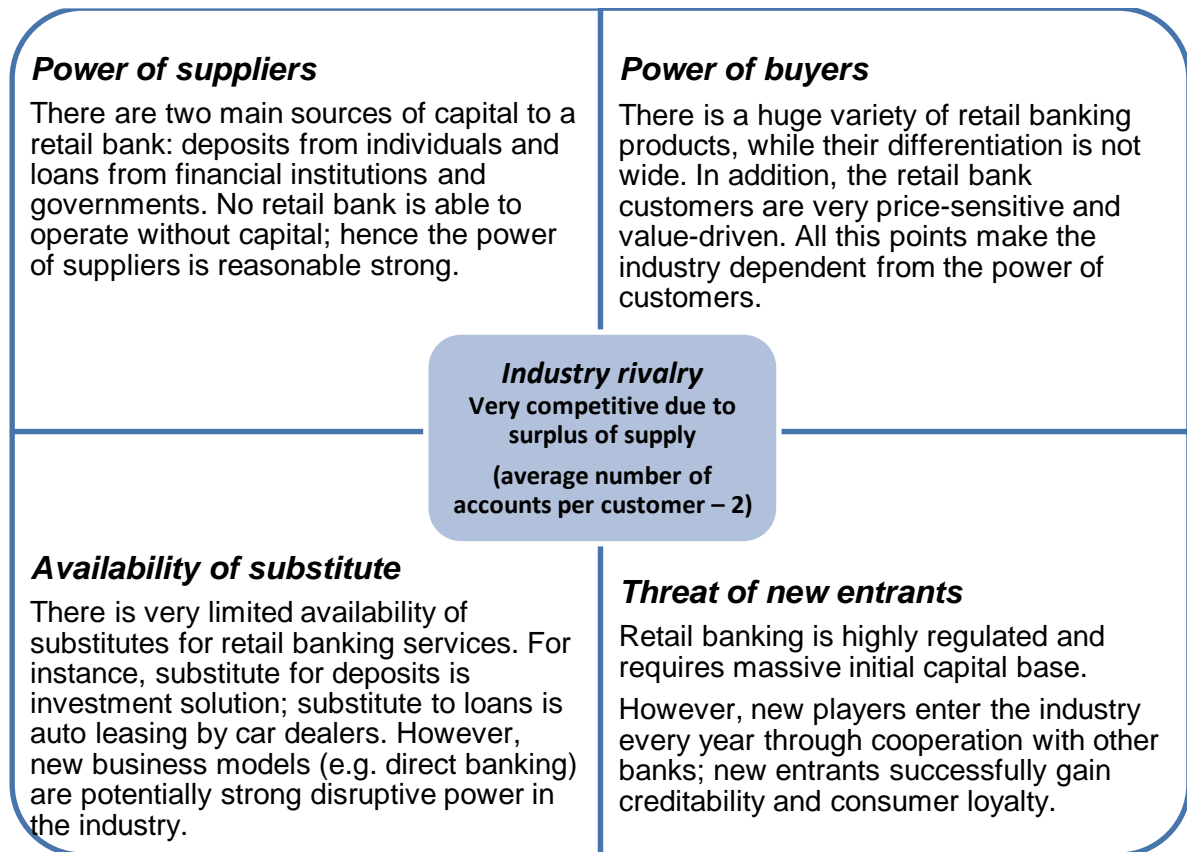


Figure 23. Porter's five forces analysis of retail banking industry

To summarize the Porter's five forces analysis above, the retail banking industry is considered highly competitive. Indeed, the banking is one of the oldest and mature industries. Anyone who needs a bank account already has one or even a couple of them. There are two main competitive advantage strategies which help retail banks to attract new customers and improve loyalty: finance-related and value-related. Finance-related strategies include lower account fees and higher interest rates. Value-related strategies refer to a good customer service, convenience of services and channels, additional services. The author expects two tendencies in the industry to continue: implementation of digital technologies and further mergers and acquisition of FinTech and local banks by large banks.

6.2 Direct Banking: Business Model Evaluation

This subchapter presents direct banking concept evaluation. First, the business model is analyzed through SWOT analysis; then direct banking is studied using growth-share matrix and product/marketing expansion grid to explain to the readers how the business model can be implemented to the existing product range.

SWOT analysis

Business model evaluation is made in the form of SWOT analysis. SWOT stands for Strengths, Weaknesses, Opportunities and Threats and represents a marketing strategy tool used for analysis of projects, organizations and business models (Armstrong & Kotler 2012, 53-54).

Strengths show advantages of a project, its internal resources and capabilities. Weaknesses are formed by internal limitations of a project such as lack of resources or capabilities. Opportunities are possible advantages that could be used by a company. Last but not least, threats are the elements of the external environment that show possible challenges in a project. (Armstrong & Kotler 2012, 53-54.) The key findings from the SWOT analysis of the case company's mobile game monetization strategy are summarized in the figure below.

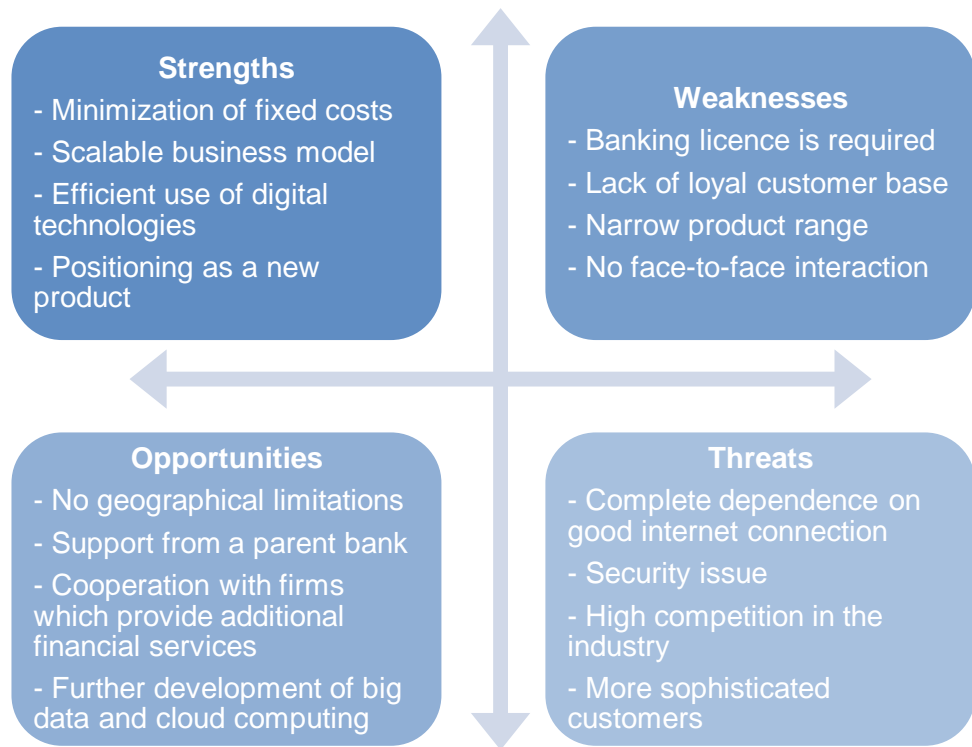


Figure 24. SWOT analysis of Direct Banking business model

Strengths

Strengths are internal advantages of the business model's functions and capabilities (Armstrong & Kotler 2012, 53). Virtual bank does not need to pay branch rent, utilities and to branch officers because of the absence of branches. Also, direct banks do not have own ATM chain and pay for each withdrawal of their customers to the partners. Even distribution channels (post or courier) are usually paid per delivery. It leads the discussion to another internal advantage of the business model - scalability. It means that, for instance, bank does not need to open a new branch and hire ten new employees to provide service to 5.000 new customers. Due to a high integration of digital technologies, direct banks can be easily expanded. Digital technologies also optimize its marketing and everyday processes. For example, direct banks can easily use targeted ads on the internet according to previous customer's session, while traditional banks still use impersonalized offline marketing channels (TV, newspaper, etc.). The final

strength is the ability to position a bank under a new brand. Traditional banks may benefit from customers who had a bad experience with the main bank. While young banks profit from

Weaknesses

Weaknesses include internal limitations which do not allow company achieve its objectives (Armstrong & Kotler 2012, 53). The first disadvantage of the business model is that it does not exempt a bank from getting a banking license (see chapter 2.5). In the majority of cases, direct bank is designed as a new brand, so young bank does not have a loyal customer base. Further, the business model usually implies basic product range: bank account, international bank cards, transitions, etc. This narrow product range might be a disadvantage for customers who need loans, investment or private banking services. Finally, the online questionnaire results analysis demonstrated that only 27 percent of retail bank customers are positive about no face-to-face interaction banking experience.

Opportunities

Opportunities are advantageous external factors of a business model (Armstrong & Kotler 2012, 53). The first opportunity for the direct banking business model is its geo-independence. Both direct bank customers and direct banks are not limited to branch or ATM chain. Moreover, banks in the European Union can open a bank account for any EU residents, which provide additional opportunities for European direct banks. Since some of the direct banks are subsidiaries of traditional banks, young banks may get support from their parent organization, for instance, marketing investments, access to ATM chain or cooperative backend. As it was discussed in chapter 3.2.2, direct banks can create an ecosystem with other partners, for example, with insurance companies, investment firms and mortgage organizations. Cloud computing, big data and analytics are surely very perspective topics for all retail banks. Furthermore, since direct

banks are initially built around digital technologies, it is easier for them to implement a new feature in big data and cloud computing.

Threats

Threats are current and possible external factors that complicate company's operations capabilities (Armstrong & Kotler 2012, 53). The most obvious threat is a bad internet connection. This is also the reason why direct banks are not able to enter some South American, African or Asian markets. In addition, bank's servers might be accidentally or purposely blocked for access in some regions. In this case direct bank is not able to operate. Another threat is a high risk of security issues. Significant security accidents might ruin the reputation of the business model. As it was discovered in the Porter's five forces analysis, there is a very high rivalry in the industry which makes it not only complex to enter the industry but also successfully operate. The last possible threat is that customers' needs and wants would increase over time, so direct banks should pay attention to tendencies and customer feedback.

Direct banking in business portfolio

Besides the analysis of internal and external advantages and disadvantages of a certain business model, it is also important to evaluate the role of a business model in existing business portfolio. Therefore, it is crucial to identify what is the place of direct banking product in a portfolio. For this section, the author takes a common business portfolio of a traditional bank as a basis for analyses and assumes that a bank intends to design a direct banking product (digital bank models A, B and C; see chapter 3.3.3). Therefore, this section is especially devoted to traditional banks that already offer different retail banking products and consider direct banking product as a differentiation opportunity.

Growth-share matrix

Growth-share matrix evaluates market share and market growth rate to classify existing products into four categories. Stars represent fast-growing

and high-share products which require significant investments and which eventually become cash cows. Cash cows are established low-growth, high-share products which do not need investments to hold market share. Question marks are low-share products with high-growth market rates; with big investments, question marks might become stars. Finally, dogs are low-growth, low market share products which may generate enough cash to exist but it is not a significant source of cash. (Armstrong & Kotler 2012, 42-43.)

The figure below illustrates the growth-share matrix regarding direct banking product in a traditional bank.

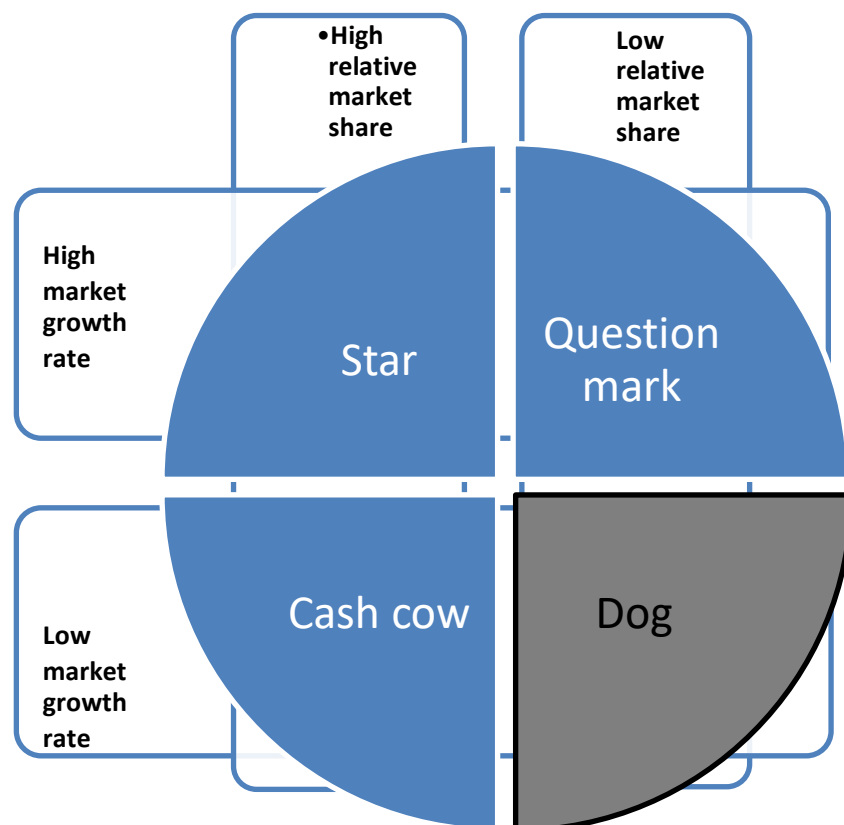


Figure 25. Growth-share matrix of direct banking product

Direct banking product operates in the low-growth retail banking industry because there are stable performance results observed in the last years.

Direct banking demonstrates low relative market share because traditional branch-centric products are still in high demand. The growth-share matrix analysis shows that direct banking product is a dog when the product is part of traditional bank product range. It is important to note that the result of the analysis is caused by direct banking product positioning. Traditional banks target this kind of products for digital-native customers who prefer manage financial services through web or app channels.

Ansoff matrix

Ansoff matrix is also known as product/market expansion grid. This tool helps to identify company growth opportunities through analysis four different development strategies. Market penetration represents firm's growth by boosting sales of the current product to the existing segment without product amends. Market development means selling the current product to new segments. Product development implies company growth through offering modified or new product to the existing segments. Finally, diversification is development growth strategy which means starting up or acquiring a business in the new market and outside current operations. (Armstrong & Kotler 2012, 44-45.)

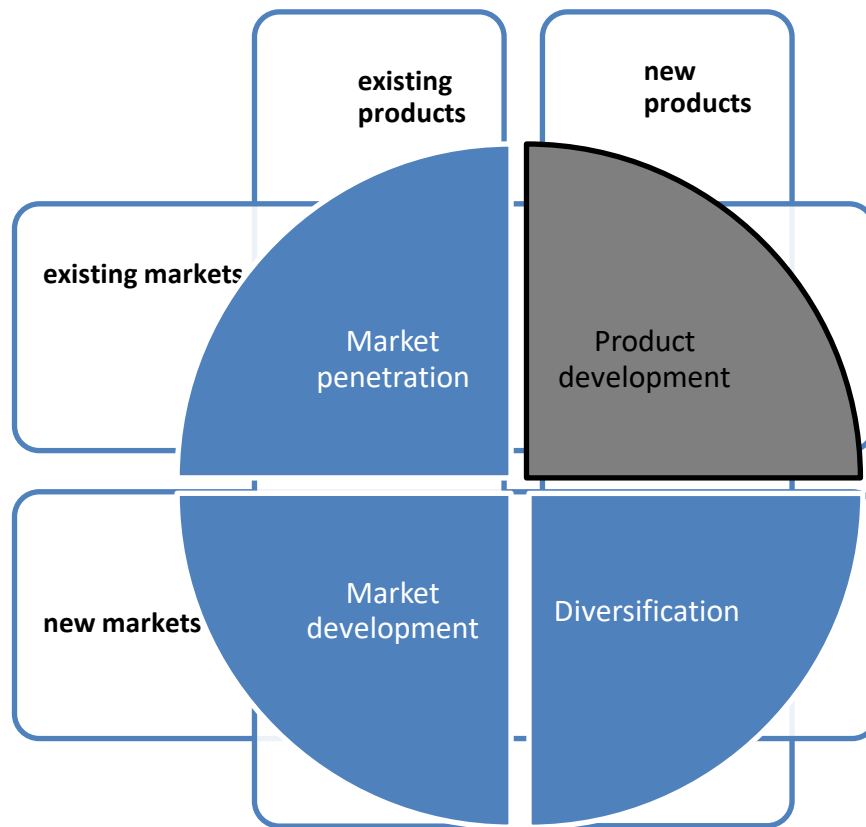


Figure 26. Product/Market expansion grid of direct banking product

Direct banking product is a bank account which can be managed only via online channels, so the product located in existing market of retail banking, but the approach is new. Accordingly, direct banking is offered to the same customers and gives bankers an opportunity to sell a new product to clients who want branchless and more digital experience.

6.3 Customer-driven Marketing Strategy

This subchapter introduces customer-centric marketing strategy for direct banks. The strategy is supported by 4C marketing mix and step-by-step customer-driven marketing plan. The subchapter aims to summarize information from the previous sections and to draw conclusions in the visualized form of informative tables.

Integrated marketing mix of a direct bank

The marketing mix is a combination of marketing tools (product, price, place and promotion) which ultimately pursue the preferred response from a targeted audience. Considering direct banking's customer-centricity, it makes sense to evaluate marketing mix from both bank and customer perspectives. Thereby, a product represents customer solution or the mixture of goods-and-services which satisfies customer needs. Price means customer cost, which does include not only purchasing price, but also maintenance fees, usage and disposing costs. Place transforms into a convenient availability of required services and products. Last but not least, communication represents both-ways interaction, instead of one-way promotion approach. (Armstrong & Kotler 2012, 51-53.)

The table below illustrates the shift in 4C marketing mix from a traditional bank to direct bank.

Table 4. Shift of 4C marketing mix from traditional bank to direct bank

	Traditional bank	Direct bank
Customer solution	Very diverse product range. Current account products are distinguished (for students, workers, individual entrepreneur).	→ 1-2 current account products (i.e. basic and premium).
Customer cost	Complex and long price list of fees items. In addition, customers are sometimes asked to maintain a minimum balance or regularly top up a certain amount.	→ Retail bank customers turned out to be very price-sensitive -> eliminate account fees and lower other fees. Some direct banks (e.g. N26, Revolut) offer special advanced product for active customers (international

			transactions, withdrawals abroad) for a certain monthly fee.
Convenience	Distribution through branches. Increasing importance of online channels; however, some activities require in-person visit to a branch. Dependent on geographical factors.	➔	Initial distribution through post or courier. All further interactions are managed via user-friendly online tools.
Communication	Mass-market promotion.	➔	Online targeted communication. Tailored message and customized offers.

Step-by-step customer-driven marketing strategy

This section answers two important questions for direct banks: “Which customers to serve?” and “How do direct banks should serve them?”. By defying major steps, direct bank management may learn how to create a more efficient marketing strategy which is attractive to both existing and potentially new customers. Customer selection steps include segmentation, which is a process of dividing of a market into smaller segments that require separate strategies; and targeting of the most attractive segments. Value proposition steps consist of differentiation of market offerings, and distinctive, clear, competitive and desirable positioning of a certain product. (Armstrong & Kotler 2012, 191.)

The table below demonstrates step-by-step customer-driven marketing plan for direct banks.

Table 5. Step-by-step plan of customer-driven marketing strategy for direct bank

	Steps of customer-driven marketing strategy	Recommendations on strategy
Customer selection	Segmentation	<p>Geographic segmentation: not critical; limited to bank card delivery destinations</p> <p>Demographic segmentation: age restrictions by local jurisdictions; income requirements might be set for credit card bank accounts; customer's residence status must meet local jurisdiction's requirements</p> <p>Psychographic segmentation: social class and lifestyle do not matter</p> <p>Behavioral segmentation: prefers online channels over offline channels; able to use internet and/or smartphone</p>
	Targeting	Differentiated (so-called, segmented) marketing: the direct banking product is focused on digital-native, young customers and/or people who have had a bad experience with traditional banks.
Value proposition	Differentiation	The product should be defined by customers: "Fully digital bank which provides safe and easy banking services through beautiful online tools."

	Positioning	<p>Direct bank should promote that it is important (reliable provider of financial services), distinctive (no branches, user-friendly online/mobile tools), superior (easy everyday banking), communicable (good customer service, two-way communication), preemptive (customers still need to go to a branch to manage basic services), affordable (no account fees), profitable (cashback, higher interest rates).</p> <p>Possible value propositions are more for less, the same for less or less for much less, depending on ATM chain, international transaction and additional services availability.</p>
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As marketing strategy plan for direct banks is established, the main question of the research is answered and the main objective is accomplished. The next chapter concludes the thesis report by providing answers to all research questions and complementing with final information about the research.

7 CONCLUSION

This chapter summarizes the found and collected data and concludes the theoretical and the empirical parts of the thesis report. This chapter intends to provide answers to the research questions which were defined at the early stage of the research. Also, this chapter discusses the validity and reliability of the study and provides suggestions for further research.

7.1 Answers to Research Questions

The main goal of the research was to establish an efficient marketing strategy plan for a direct bank. As the topic is complex, it required introducing to the readers some background information and basic concepts beforehand. Therefore, sub-questions should be answered first, and the answer to the main question is provided at the end.

What are the current digitalization trends in retail financial services?

Nowadays the emerging trends in retail banking are shaped by two main forces: development of digital technologies and increase in customers' expectations and needs. Currently, active discussions are going around the future of bank branches. With banking web tools and mobile banking apps, the importance of offline channels (branches and ATMs) has declined. Although bank branches are closing in many countries, bank managers see the future of bank branches as a more digital and modern element of reshaped banking platform. Big data allows banks to use cloud computing and deeper data analysis to digitalize banking operations and make them more efficient and less expensive. Also, banks globally are trying to engage young generation by designing special banking solutions and new products for this target group. By attracting youth generation, banks grow their customer base and occupy market share in the potentially highly profitable segment. Current digitalization trends in retail banking are described more thoroughly in chapters 2.7, 3.2.1 and 3.2.2.

What is a direct bank and what is people's attitude towards a branchless bank?

As a result of the tendencies mentioned in the previous answer, retail banking industry proposed two business models in order to meet requirements of the reshaped industry. One of them is direct banking, which applies to highly digitalized financial institutions that do not have a branch network, allowing customers to manage their financial needs via online channels (web, mobile app).

An online questionnaire was created and shared in order to study bank customers' attitude towards direct banking concept. The results illustrate that people still value ATMs while the significance of bank branches is rather low. This is a good result for the business model of direct banking. However, it was also revealed that bank customers have a negative attitude towards the main characteristics of direct banking concept. Nevertheless, they may consider opening an account in a direct bank in the future.

More information about direct banking concept is provided in chapter 3.3, while customers' opinion on virtual banking is given in chapter 5.

How does the current framework of European direct banking look now?

In order to answer this question, consolidated table of all fully direct banks in Europe was created. The table shows that there are 28 fully operating banks in Europe as of October 2017. The concept of direct banking is not spread equally across the regions. Indeed, there are many branchless banks in Germany, France, the UK, Eastern Europe and several in Southern Europe, while there are no direct banks in Northern Europe. The framework illustrates that most of the direct banks are subsidiaries of traditional parent banks. The consolidated table of active direct banks is provided in Appendix 1. The analysis of the table can be found in the chapter 3.4.2.

Which factors force people to switch a bank?

The research shows that retail bank customers are currently reasonably flexible and on the average use financial services of more than two financial providers simultaneously. Therefore, in modern conditions of the industry, marketing plays an important role in retail banking and banks should know the factors which may influence customers' decision to switch banks. Any relationships or connections to a new bank is the main factors why a certain bank is more preferred. Convenient locations and good feedback play an important role as well. Millennials and young adults turned out to be very price-sensitive, so almost half of them may switch a bank because of lower fees. They also value good customer service and ATM locations convenience, so if these needs are not fulfilled enough, young bank customers may switch a bank. All factors which influence customers' decision to switch a bank are listed in chapter 4.3.

The main question of the research is the following:

How should the marketing strategy of a direct bank be like?

Industry marketing analysis tool showed that the retail banking industry is highly competitive and strong powers of suppliers, customers with a significant threat of new entrants. Like many other business models, direct banking has its competitive advantages and weaknesses. By implementing the branchless model, banks may minimize expenditures and be able to extend its operations easily to new regions. On the other hand, the majority of direct banks are designed as new brands, so there is a complex task to build a loyal customer base. Marketing strategy plan demonstrated that all four aspects of the marketing mix (product, price, place and promotion) of direct bank differ from marketing mix of a traditional bank. Customer-driven marketing strategy establishes an efficient customer selection plan; banks should focus on a segment of digital-native customers. The value proposition is a cornerstone of competent customer-centric strategy; direct banks should promote its unique differences and pay attention to user-friendly online tools, lower

account fees and additional digital features. Full marketing strategy plan for direct banks is provided in chapter 6 of the thesis report.

7.2 Validity and Reliability

Validity is a concept used to measure the extent to which research results meet the research objectives (Saunders et al. 2009, 157). This thesis uses both primary and secondary data. For secondary data, academic and semi-academic books, companies' reports related to the topic and scientific journals were utilized; only up-to-date and credible online sources were used. For primary data, an online questionnaire was designed via Google Forms and shared with bank customers in different parts of Europe. Data gathering and analysis were conducted properly, the sample size of 152 respondents is sufficient, so the study can be considered valid.

Reliability is a concept used to measure the extent to which research is compatible with similar studies (Saunders et al. 2009, 156). The research results can be considered highly reliable in this period of time in Europe. However, due to changing customer behaviour and dynamic customer needs, the results may vary in the further studies. The online questionnaire had a description of direct banking concept in order to avoid any misunderstanding. Thus, it can be stated that the study is reliable.

7.3 Suggestions for Further Research

This thesis was conducted with the aim to analyze customers' perspective on the concept of direct banking. A further study could, on the other hand, focus on studying bank managers' opinions on the business model. In addition, the scope of this research only included European fully operating direct banks so that further researches can be focused on the concept implementation in other regions. Even though the business model is relatively new, direct banks' performances, market shares and reasons of direct bank closures can be investigated.

8 SUMMARY

The study aimed to provide a better understanding of current digitalization trends in the retail banking industry, its reasons, and influence on consumer banking sector. One of the emerging business models, direct banking, was taken as the central research business phenomenon.

The thesis began with an introduction of a banking industry, explaining functions and types of banks, as well as earnings methods and regulations which are currently relevant in the industry. The next chapter of the thesis report was dedicated to digital transformation and digital disruptions in the retail banking industry, which caused new business models. Direct banking is one of them, so the concept of the branchless bank was explained in detail. The outline of the concept application in Europe was provided. The theoretical part finished with revealing the importance of marketing in the banking business, disclosing customer behavior in banking, and defying the factors why customers switch their current banks.

Marketing strategy plan was addressed to both traditional local banks, which want to diversify their product line with direct banking product, and potential new players, who consider entering the market as solely Direct Banks. The empirical chapter included recommendations on establishing an efficient marketing strategy for direct banks. The strategic plan was based on the desk research and results of the empirical analysis. The results of this research and answers to the research questions are given in the conclusion.

The study showed that bank customers still actively use ATMs, but branches do not play an important role in their banking experience anymore. It was also revealed that bank customers have a negative attitude towards the main characteristics of direct banking concept. However, they may consider opening an account in a direct bank in the future. Validity and reliability of the research are proven. The suggestions for further research on digitalization tendencies in retail banking are provided.

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APPENDICES

APPENDIX 1.

Table 6. List of direct banks in Europe

	Name	Country of HQ	Number of customers (millions)	Area of operation	Digital bank model	Parent company	Website
1	ING DiBa/ ING Direct	Germany	8.5 (2017)	Germany, Austria, France, Italy, Spain	A	ING Group	www.ing-diba.de www.ing-diba.at www.ingdirect.fr www.ingdirect.it www.ing.es
2	Tinkoff bank	Russia	6.0 (2017)	Russia	D	-	www.tinkoff.ru
3	mBank	Poland	5.5 (2017)	Poland, Czech Republic, Slovakia	C	Commerz bank	www.mbank.pl
4	DKB AG	Germany	3.6 (2017)	Germany	D	-	www.dkb.de
5	Alior Bank	Poland	3.0 (2017)	Poland	D	-	www.aliorbank.pl
6	Comdirect	Germany	2.7 (2015)	Germany	B	Commerz bank	www.comdirect.de
7	Hello Bank	France	2.5 (2016)	France, Belgium, Germany, Italy, Austria	B	BNP Paribas	www.hellobank.fr www.hellobank.be www.consorsbank.de www.hellobank.it www.hellobank.at
8	Allianz Bank Financial Advisors	Italy	1.7 (2016)	Italy	C	Allianz Group	www.allianzbank.it

9	First Direct	UK	1.35 (2017)	UK	B	HSBC	www.firstdirect.com
10	Fineco	Italy	1.05 (2016)	Italy	B	UniCredit Group	www.finecobank.com
11	Revolut	UK	0.9 (2017)	EU and Switzerland	D	-	www.revolut.com
12	Smile	UK	0.7 (2016)	UK	B	The Co-operative Bank	www.smile.co.uk
13	Boursorama Banque	France	0.6 (2015)	France	C	Societe Generale Group	www.boursoramba-banque.com
14	Fortuneo Bank	France	0.6 (2016)	France, Belgium, Switzerland, Luxembourg	C	Crédit Mutuel Arkéa Group	www.fortuneo.fr
15	N26	Germany	0.5 (2017)	17 Eurozone countries (all excl. Cyprus and Malta)	D	-	www.n26.com
16	Mondo	UK	0.4 (2017)	UK	D	-	www.monzo.com
17	IWBank	Italy	0.2 (2016)	Italy, Germany, France	B	UBI Banca	www.iwbank.it
18	Fidor Bank	Germany	0.2 (2016)	Germany	C	Groupe BPCE	www.fidor.de

19	NIBC Direct	Netherlands	0.17 (2015)	Netherlands, Germany, Belgium	A	NIBC Bank	www.nibcdirect.nl www.nibcdirect.de www.nibcdirect.be
20	Atom bank	UK	0.15 (2016)	UK	D	-	www.atombank.co.uk
21	WeBank	Italy	0.15 (2016)	Italy	C	Banca Popolare di Milano	www.webank.it
22	Monabanq	France	0.1 (2015)	France	B	Crédit Mutuel CIC Group	www.monabanq.com
23	Telenor banka	Serbia	0.1 (2015)	Serbia	B	Telenor Group	www.telenorbanka.rs
24	RaboDirect	Netherlands	0.09 (2015)	Belgium, Ireland, Germany	A	Rabobank Group	www.rabobank.be www.rabodirect.ie www.rabodirect.de
25	Starling Bank	UK	0.005 (2017)	UK	D	-	www.starlingbank.com
26	LKXA	Spain	N/A	Spain	A	CaixaBank	www.imaginbank.com
27	Rocket Bank	Russia	N/A	Russia	B	Bank Otkritie	www.rocketbank.ru
28	Tandem	UK	N/A	UK	C	Harrods Bank	www.tandem.co.uk

APPENDIX 2. Online Questionnaire

Survey: digitalization of banking in Europe

This short questionnaire is intended to understand people's satisfaction with everyday banking and their attitude towards digital technologies in retail banking.

If you currently live in Europe and have a bank account, you are kindly invited to participate. The survey will likely take 5 minutes of your time.

Thank you for participation!

What country are you from?

(Short-answer text)

How old are you?

(Short-answer text)

[Number Greater than 1]

How many active bank accounts do you have?

(Linear scale from 0 to 5)

(Multiple-choice grid)

	Never	Few times a year	Few time a month	1-2 times a week	3-6 times a week	Every day
Branch (bank office)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Web banking	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Mobile app	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
ATM	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Contact centre (via phone/email)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

(Linear scale)

1 2 3 4 5 6 7 8 9 10

Not satisfied at all ○ ○ ○ ○ ○ ○ ○ ○ ○ ○ Very satisfied

Please select the most critical points you do not like about your current bank(s).

(Checkboxes)

- ☐ Account fees
- ☐ Limited ATM chain
- ☐ Branch availability
- ☐ Bank card design
- ☐ No contactless payment option (e.g. Visa Paywave, MasterCard Paypass, Apple Pay, Android Pay)
- ☐ Poor customer service
- ☐ Foreign currency surcharges
- ☐ Brand of the bank
- ☐ Inconvenient online/mobile tools
- ☐ Inflexibility, complexity
- ☐ Insufficient reliability
- ☐ (Other...)

Direct banking

The topic of the final questions is Direct Banking.

Direct banking...

... operates without branches (i.e. bank offices)

... offers all services remotely via online/mobile tools

... is built around digital technologies such as big data and cloud systems

Evaluate the following statements related to direct banking features according to your needs and preferences:

(Multiple-choice grid)

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
I do not want to be a customer of a bank without branches.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Face-to-face meetings with bank staff are important for me.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
I do not mind being a customer of a small bank.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
I prefer to be a customer of a bank which has implemented advanced digital technologies.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
I rarely use cash.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Would you open an account in direct bank?

(Multiple choice)

- ☐ Yes
- ☐ No
- ☐ Maybe
- ☐ I am already a customer of direct bank

If you are already a customer of direct bank, please write down your bank:

(Short-answer text)

Please select 3 factors that would encourage you to open an account in direct bank:

(Checkboxes)

[Select exactly 3]

- ☐ Fee-free account
- ☐ Cashback
- ☐ Higher interest rates
- ☐ Being able to take a loan, purchase insurance or invest via web banking or bank mobile app
- ☐ Ability to use any ATM with no fees (considering withdrawal amount limitation)
- ☐ Excellent customer service (chat/video calls)
- ☐ User-friendly online/mobile tools
- ☐ Discounts and special offers
- ☐ (Other...)